NATIONAL OPEN UNIVERSITY OF NIGERIA

SCHOOL OF MANAGEMENT SCIENCES

COURSE CODE: ENT 419

COURSE TITLE: **INTERNATIONAL BUSINESS**

ENT 419: INTERNATIONAL BUSINESS

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NATIONAL OPEN UNIVERSITY OF NIGERIA

COURSE GUIDE ENT 419: INTERNATIONAL BUSINESS

ENT 419: International Business is a one semester two credit unit course. It is available for all 400 levels under graduate programmes in school of business and human resources management. The courses consist of sixteen (16) study units and subdivided into three modules covering such areas as: an overview of international trade and business; international business strategies and ethical and financial aspects of international business.

This course guide tells you briefly what the course is about, relevant textbooks to consult, and how you can work your way through this course material. It also contains some guidelines on your tutor marked assignments and as well as self assessment exercises.

What you will learn in this Course

The major aim of international business is to expose learners to the basic concepts in international trade, international business and the basis of entering world business markets. The field of international business is challenging, most so we are a dynamic world where modern technologies have made the world business as a global village. International business can be embarked upon by any interested persons provided rules and ethics of the business are adhered to. It is arena of extending domestic market abroad. Therefore in order to achieve maximum usage of the resources, there is a need to studies some variables that affect such business activities.

Course Aims

The course aims to give you a broad knowledge of business and how this knowledge gained would be used in planning, coordinating executing necessary activities at the international business process. This would be achieved through studying:

1. International business and international trade
2. Theories of international trade
3. World business environment
4. Globalization

5. Foreign Direct Investment
6. Political Economy of international trade
7. Modes of entering international markets
8. International marketing
9. Distribution strategies
10. Exports and Imports practice
11. Multinational corporations
12. Ethical issues in international business
13. Financial influence on international business
14. International Monetary Fund system
15. International liquidity and
16. International finance and lending institutions

Course Objectives

I order to achieve the aims set out above, the course sets overall objectives. You will also realize that each course unit objective s is always included at the beginning of each unit. Hence, you are encouraged to kindly read through the specific objectives before studying through the unit. However, the following are some of the broad objectives of this course. Thus, after thorough studying of the course, you should be able to:

1. Differentiate between international business and international trade
2. Explain mode of entering world markets
3. Explain globalization
4. Explain foreign direct investment (FDI)
5. Explain exports and imports practice
6. Describe mode of operations of multinational corporations (MNCs)
7. Explain some ethical issues on international business
8. Explain international monetary fund and its influence on international business
9. Explain international liquidity
10. Explain International finance and lending institutions and host of others

Working through this Course

It is important that you patiently read through the units and consult the suggested texts and other related materials. The units consist of self assessment exercises and tutor marked assignments to help your studies.

Course Material

The major components of these course materials are:

1. Course Guide
2. Study Units
3. Main text
4. Activities and Tutor marked assignments
5. References and Further reading

Study Units

There are sixteen (16) study units in this course. This are

Module One: An Overview of International Trade and International Business

This module examined the fundamental factors that must be considered before going into international business. This is very imperative in order to avoid losing huge resources invested in international business by interested individuals. This module composes of:

1. Introduction to international business
2. Basis of international trade
3. World market environment
4. Globalization
5. Foreign Direct Investment (FDI) and
6. Political Economy of international Trade

Module Two: International Business Strategies

This module which comprises of five units examined strategies necessary to maintain fair market shares of the international business. This is important because of the dynamism of the international business, changes in international business practice This module thus comprises of:

1. Mode of entering international markets
2. International marketing
3. Distribution strategies
4. Exports and imports practices and
5. Multinational corporations (MNCS)

Module Three: Ethical and Financial Aspects of International Business

This module also comprises of five units. It discusses ethical issues on international business; financial influence on international business activities and lending institutions. This module therefore composes of:

1. Ethical issues on international business
2. Financial influence on international business
3. International Monetary Fund Systems
4. International liquidity and
5. International finance and lending institutions

Textbooks and References

You should note that there are no compulsory textbooks for the course. However, you are encouraged to consult some of the listed texts for further readings at the end of each unit.

Assignment File

The assignment file will be made available to you. Thus, you will find all the details of the work you must submit to your tutor for marking. The marks you obtained in these assignments will count towards the final mark you will obtain for the course.

Assessment

Your performance in this course will be based on two major components. These are tutor marked assignments (TMAs) and written examination.

The tutor marked assignment -------------------------------- 30%

Final Examination-- 70%

Grand total 100%

The self assessment exercises are designed to aid your studies. They are not required to submit for grading; however they are very important that you attempt them.

Tutor Marked Assignment

At the end of each unit, there is a tutor marked assignment which you are encouraged to do. The centre director will inform you the number of tutor marked assignments to be submitted.

Final Examination and Grading

At the end of the course, you are expected to sit for a final examination of three hours duration. The final examination grade is 70 percent while the remaining 30 percent is from TMAs. The final examination is a reflection of what you have read and previous TMAs encountered.

How do get the most from this course

The distance learning system of education is quite different from the traditional university system. Therefore you are encouraged to study the units thoroughly. The physical absence of the teacher has been replaced with step by step studying of the units and the necessary built in self assessment exercises. Hence you to read and understand the course, not reading the units like novel.

Facilitators/Tutorials

Detailed information about learning support services or tutorial contact hours will be communicated to you through the centre directors of your respective centres. Other academic counseling will be offered to you by the academic counselors at the centre. However, you are encouraged to study the course material/units before attending any tutorial. This will help you to gain added advantage while the facilitator discusses such units being discussed. This will also enable you to contribute effectively on the discussion.

Summary

International business is a discipline that dwells on international business practices. It concerned itself with environmental variables, cultural differences, language differences, economic differences, ethical differences, and so forth. It aimed to create opportunities to interested individuals and groups beyond domestic activities. Therefore, it is imperative to study the key variables that shape such activities.

Conclusion

Welcome to the world of international business, wishing you a successful study

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UNIT 1: Introduction

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1.0 Introduction

Trading is no longer limited to some selected individuals and countries again. Trade cut across nations and individuals of the world now days. It is more challenging and appreciated than before. This is because there is a fundamental shift in the world economy. We moving away from a world in which national economies were relatively self-contained entities, isolated from each other by barriers to cross-border trade and investment, by distance, time zones and language and national differences in government regulation, culture and business systems. And we are moving toward a world I which barriers to cross- border trade and investment are declining and perceived distance is shrinking due to advances in transportation and telecommunication technology. This unit examines international trade/business versus domestic business

2.0 Objectives

On successful completion of this unit you should be able to:

a. Explain international business

b. Explain domestic business
c. State the need for international business
d. State differences between domestic trade and international business and
e. State reasons for international trade and barriers to international trade

3.0 Main Text

3.1 International Business

International, business is the study of transactions taking place cross national borders for the purpose of satisfying the needs of individuals and organizations. These economic transactions consist of trade as in the case of exporting and importing and foreign direct investment as in the case of companies funding corporations in other countries.
International business consists of transactions that are devised and carried out across national borders to satisfy the objectives of individuals, companies and organizations and as well as countries.
International trade is the exchange of goods and services across international borders and is also known as export and imports. Exports are goods and services produced by a firm in one country and then sent to another country. For example, many companies in Dubai export clothing and other textile products to Nigeria. While imports are goods and services produced in one country and brought in by another country. For example, Japan is a major importer of petroleum because it most relies on outside suppliers for all of its energy needs.
Domestic/home trade is the study of transactions taking place within a country. That is, all transactions that took place among Nigeria states is refers to as home trade. Home trade aids international business. Information on exports and imports is important to the study of international business, namely:

2. Trade is the historical basis of international business and trade activities help us understand multinational enterprises (MNEs) practices and strategies
3. Trade helps better understand the impact of international business on world economies
4. Exports and imports are the main drivers of international trade

Czinkota et al (2002) states that international business could be and are always interrelated; they are export and import trade or direct foreign investment. International business could take a form of owning a subsidiary company fully, joint ventures, licensing, and franchising or management contract. Definition of international business bordered on two issues, namely.

a. National borders

b. Transactions

Nations have borders; it therefore means transacting business across borders is an international business, whether the business is within nations in the same region or across two different regions.

3.2 Brief History of International Business

The field of modern international business began to develop in the 1950s. At this time, there were not great number of Multinational Enterprises (MNEs) and most of them were American. World War II had ended less than a decade before and many nations including Japan and European countries were more concerned with rebuilding than overseas investing. Early international business textbooks were written by American professors and offered a general descriptive approach to the field. There were few international research studies to provide substantive information. International companies that served as teaching examples were often those with international divisions' rather than true MNEs

During the 1970s and 1980s the field of international business changed greatly. The economic growth of Europe and Japan, coupled with great strides by newly industrialized countries, resulted in more and more attention being focused on international business

The 1990s saw the emergency of a strategic management focus for drawing together the field of international business. The descriptive ideas of the 1950s and 1960s, and the analytical ideas of the 1970s and 1980s were now being combined into an integrative approach. Historical and quantitative research was now being incorporated into models for describing, explaining and helping predict what was happening in the international arena

3.3 Need for International Business

International business as a course and a study is necessary for students of business management and others because every business man need to take advantage of the following.

a) You need international experience to equally manage your business at home, simply because the whole world is now a global village.

b) The Chief executive officers and managing directors need courses in international business to cope with human resources management

c) International business is needed for managers to become familiar with other markets, culture and customs of other business markets.

d) It will equally increase the involvement of the firm in international business, thus its procedures and practices need to be studied.

Self Assessment Exercise

List five Nigeria businesses abroad

3.4 Differences in International Business

International business and domestic business differ for the fact that international business has three forces to content with once it operate outside the shore of its country. They include:

- ❖ Domestic
- ❖ Foreign
- ❖ International

While domestic business contends only with one group of problem which is domestic All the same, domestic business sometimes contends with issues of competing with foreign business that establish their business within the country. This are discussed in details under world business environment in the subsequent units.

3.5 Reasons for Going Abroad

Many company and business executives go abroad for such reasons as discussed below:

A) Increase profit and sales

A lot of companies' managers are under pressure to increase their company's sales and profits. Because of that, they continue to search for new market. Because of this they look for market with growth in GDP and population or an economy with high growth rate and their business is not growing at the same rate.

While increasing your companies profit and sales you must be able to.

1. Create New Market- This is created where the GDP per capital is increasing.

2. Know where there are preferential trading arrangements.

Seek for an agreement by a small group of Nations to establish free trade among them while maintaining trade restriction with all other Nations. ECOWAS is a good example.

3. Faster Growing Market- Is another way of increasing profit and sales. Because of the fast growing marketing, local companies may be willing to invest there to improve on the profit example is Liberia.

4. Improved Communication- It is a supporting reason for opening up new markets oversea because certainly the ability to communicate rapidly and less expensively with customers and subordinates by electronic mail and video conferencing has given managers confidence in the ability to control foreign operations.

Improving on profits is by obtaining greater revenues. To obtain greater revenues, you need to simultaneously introduce product in foreign markets and as well as domestic markets or they are move toward greater globalization of their operations. In addition to going international is to reduce cost of goods sold and higher overseas profits as an investment motive.

Test market is another way of increasing profit because test marketing a product in a foreign location is less important to the company than its home market and major overseas markets.

B) Protect Markets Profit and Sales

Some of the reason of going international is to

Protect Domestic Market- By so doing the company follows its customers abroad. A company that has its customers scattered around the globe, it goes international in order to protect such markets that it is serving and its multiplier effect is that it protect both the profit and sales.

Protects Foreign Market- This implies that company critically examines the economic activities, whereby in the domestic market, there are:

a) Less/Lack of Foreign Exchange

b) Local Production by competitors

c) Down Stream Markets- like NNPC building mega stations.

d) Protectionism- erecting import barriers to reduce competition.

Protecting companies Profit, Sales and markets, this could be achieved by

1. Guarantee Supply of raw materials
2. Acquire technology and management know-how
3. Geographic Diversification
4. Satisfy Management desire for expansion

Self Assessment Exercise

List factors that you considered could influence Nigeria manufacturer to relocate abroad while there are existing customers at home.

3.6 Reason for International Trade

International trade is an indispensable and inevitable activity in modern business. Here are some factors which accounted for this:

4 Factor Endowment: International trade owes it origin to the varying resources of different regions. Resources are not evenly distributed across the globe. Some areas are blessed with abundant supply of minerals such like Africa, while others have little or nothing. Some of these resources are better utilized outside its origin place.

5 Climatic condition: Some commodities can only be grow under particular climatic condition and on certain soil. Because of these differences in climatic conditions, this call for international trade among nations of the world.

6 Level of Technical Know-How: Developed countries of Europe and America have acquired special skills due to their development in technology and technical know-how. They produced machines and other advanced equipment which are not obtainable in the less developed countries , such like Nigeria, Ghana, etc In order for the less developed nations to benefits from these advanced technologies, this calls for international trade.

Barriers to International Trade

Some of the barriers to international trade are briefly explained below:

1. Government interference: Government of many nations interferes in the free flow of goods and services across the country's borders. For instance, a country can impose import duties, import quota, tariffs etc. This in no small measure woks against the attainment of principles of comparative advantage/cost and thus serves as a impediment to international trade
2. Currency differences: Each country has its own currency and before a country can trade with other countries, it must obtain the currencies of it trading partners.
3. Language Problem: Language problem make international trade difficult. Communication is vital for any successful transaction to take place
4. Legal system: The legal system of a country refers to the rules or laws that regulate behavour along with the processes by which the laws are enforced and through which redress for grievances is obtained The legal system of a country is of immense importance to international trade/business.
5. Cultural difference: A culture is defined as system of rules and norms that are shared among a group of people and that when taken together constitute a design for living. Cultures vary from community to community. These differences account for barriers in international business practice

4.0 Conclusion

International business is an aspect of modern business. It is very important especially when the whole world is linked together as a globe village. For international business manager to succeed he/she should equip himself with the requirements of the business. It is equally important to examined how international trade has be carried out in such area. This will go along in aiding such international business.

5.0 Summary

In this unit, international business and international trade were both defined and differentiated. History of international business was briefly discussed. The need for international business and reasons for international trade were discussed. Barriers to international trade were looked into.

6.0 Tutor Marked Assignment

List factors that you considered could influence Nigeria manufacturer to relocate abroad while there are existing customers at home.

7.0 References/Further Reading

Adam Smith (1776): ‘Wealth of Nations’ Irwin, Homewood

Charles, W.L.H (2008) Global Business Today, 5th Edition, New York, McGraw-Hill Companies.

Onkvisit, S and Shaw, J. J (1997) International Marketing-Analysis and Strategy, 3rd Edition, New Jersey, Prentice-Hall.

Answers to self assessment exercises

1 Some of the Nigeria businesses abroad are

a. Nigeria gas
b. Nigeria cruse oil
c. Dangote flower mill
d. Dangote Cement and
e. Cocoa seeds

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2 Factors that could influence Nigeria business men to relocate abroad include:

A) Increase profit and sales

A lot of companies’ managers are under pressure to increase their company’s sales and profits. Because of that, they continue to search for new market. Because of this they look for market with growth in GDP and population or an economy with high growth rate and their business is not growing at the same rate.

A) Protect Markets Profit and Sales

Some of the reason of going international is to

Protect Domestic Market- By so doing the company follows its customers abroad. A company that has its customers scattered around the globe, it goes international in order to protect such markets that it is serving and its multiplier effect is that it protect both the profit and sales.

Protects Foreign Market- This implies that company critically examines the economic activities, whereby in the domestic market, there are:

UNIT 2: BASES OF INTERNATIONAL TRADE

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1.0 Introduction

Whenever a buyer and seller come together, each expects to gain something from one another. The same expectation applies to nations that traded with each other. It is virtually impossible for a country to be completely self-sufficient without incurring undue costs. Therefore, trade becomes a necessary activity, though, in some cases, trade does not always work to the advantage of the nations involved. Notwithstanding, too much emphasis is often placed on the negative effects of trade, even though it is questionable whether such perceived disadvantages are real or imaginary. The benefits of trade, in contrast are not often stressed, nor are they well communicated to workers and consumers? The question is- Why do nations trade?

A nation trades because it expects to gain something from its trading partner(s). Then one may ask whether trade is like zero-sum game, in the sense that one must lose so that another will gain. The answer is no, because, though one does not mind gaining benefits at someone else's expense, no one wants to engage in a transaction that includes a high risk of losses. For trade to take place, both nations and individuals must anticipate gain from it. It is a positive sum game. This unit examines some theories with respect to nations and individual's trading.

2.0 Objectives

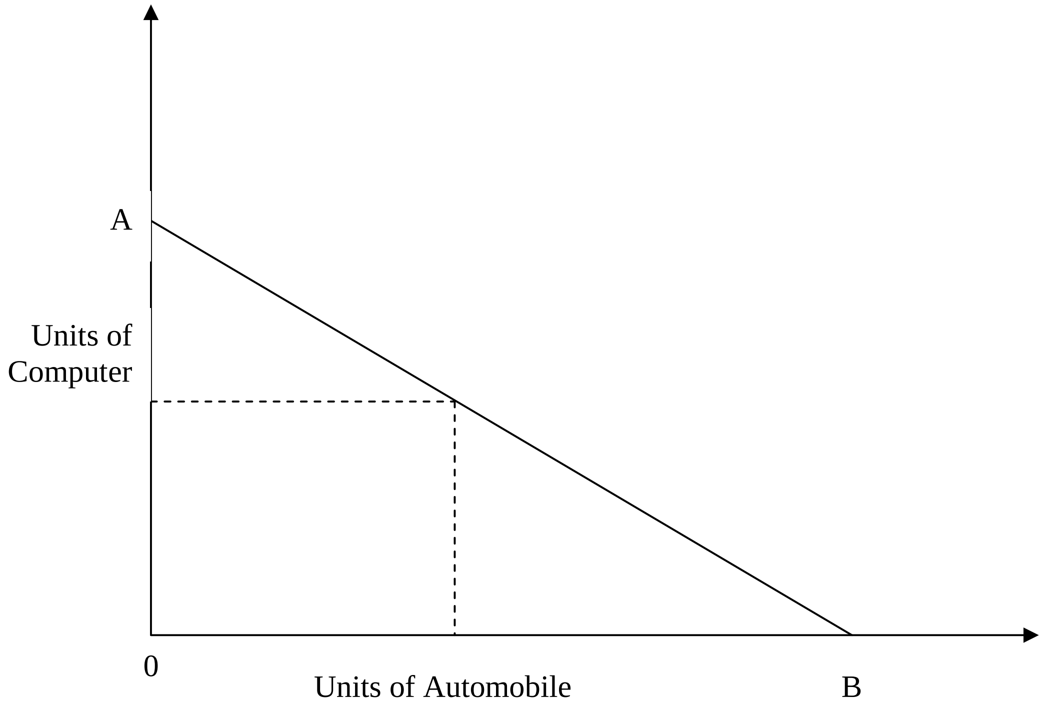
After studying through this unit, you should be able to:

1. Explain basis for trade among nations and individuals and
2. Explain some theories in respect of international trading.

3.0 Main Text

3.1 Production Possibility Curve

Without trade, a nation would have to produce all commodities by itself in order to satisfy all its needs. Table 1 below, shows a hypothetical example of a country with a decision concerning the production of two products- computers and automobiles.



(Production Possibility Curve: Constant Opportunity Cost)

Source: Onkvisit, S and Shaw, J. J (1997) International Marketing-Analysis and Strategy, 3rd Edition, New Jersey, Prentice-Hall.

This diagram shows the number of units of computer or automobile a country is able to produce. The production possibility curve shows the maximum number of units made when computers and automobiles are produced in various combinations, since one product can be substituted for the other within the limit of available resources. The country may elect to specialized or put all its resources into making either computers (point A) or automobiles (point B). At point C, product specialization has not been chosen, thus, a specific number of each of the two products would be produced.

Because each country has a unique set of resources, each country possesses its own unique production possibility curve. This curve when analyzed provides an explanation of the logic behind international trade. Regardless of whether the opportunity cost is constant or variable, a country must determine the proper mix of any of the two products and must decide whether its want to specialize in one of the two. Specialization will likely occur if specialization allows the country to improve its propensity by trading with another nation. These principles of absolute advantage and relative advantage explained how the production possibility curve enables a country to determine what to export and import.

3.2 Principles of Absolute Advantage

Adam Smith in his book titled 'Wealth of Nations' used the principles of absolute advantage as the justification for international trade. According to him, a country should export a commodity that can be produced at a lowest cost than can other nations. Conversely, it should import a commodity that can only be produced at a higher cost than other nations.

Consider for example, a hypothetical production figures for Nigeria and Ghana as shown in table 2 below.

Table 2: Possible Physical Output

	Product	Nigeria	Ghana
Case 1	Computer	20	10
	Automobile	10	20
Case 2	Computer	20	10

	Automobile	30	20
Case 3	Computer	20	10
	Automobile	40	20

From the table above, case 2 shows that given certain resources and labour, Nigeria can produce twenty computers or ten automobiles or some combination of both. In contrast, Ghana is able to produce only half as many computers (i.e. Ghana produces ten for every twenty of Nigeria produces). The disparity might be the result better skills by Nigerian workers in making this product. Therefore, Nigeria has an absolute advantage in computers. However, Ghana has an absolute advantage in automobiles.

At this point, it should be clear why trade should take place between the two countries. Nigeria has an absolute advantage for computers, but absolute disadvantage for automobiles. For Ghana, absolute advantage exists for automobiles and absolute disadvantage for computers. Therefore, if each country specializes in the product for which it has an absolute advantage, each can use it resources more efficiently while improving consumer welfare at the same time.

This implies that since Nigeria would use fewer resources in making computers, it should produce these products for its own consumption as well as for export to Ghana. Base on this arrangement, Nigeria should import automobiles from Ghana rather than manufacture them itself. While for Ghana, automobiles would be exported and computers imported.

Thus, for practicability each person should concentrate on and specialize in the craft that person has mastered. Similarly, it should not be practical for consumers to attempt to produce all the things they desire to consume. One should practice what one does well and leave the production of other things to people who produce them well.

Self Assessment Exercise

Briefly explain the term ‘absolute disadvantage’

3.3 Principles of Comparative Advantage

One problem with the principle of absolute advantage is that it fails to explain whether trade will take place if one nation has absolute advantage for all products under consideration. Case 2 of table 2 above shows that situation. Note that the only difference between case 1 and case 2 is that Nigeria in case is capable of making thirty automobiles instead of the ten incase 1. In the second instance, Nigeria has advantage for both products, resulting in absolute disadvantage for Ghana for both. The efficiency of Nigeria enables it to produce more of both products at lower cost.

At first glance, it may appear that Nigeria has nothing to gain from trading with Ghana. However, nineteenth-century British Economist, David Ricardo, perhaps the first economist to fully appreciate relative cost as a basis for trades. He argues that absolute production costs are irrelevant. More meaningful are relative production costs, which determine whether trade should take place and which items to export and import. According to his principles, a country may be better than another country in producing many products, but should only produce what it produces best. Essentially, it should concentrate on either a product with the least comparative disadvantage. Conversely, it should import for which it has the greatest comparative disadvantage or one for which it has the least comparative advantage.

Case 2 shows how the relative advantage varies from product to product. The extent of relative advantage can be found by determining the ratio of computers to automobiles. The advantage can be found by determining the ratio of computers to automobiles. The advantage ratio for computers is 2:1 (i.e. 20:10) in favour of Nigeria. Also, in favour of Nigeria to a lesser extent is the ratio for automobiles, 1.5:1 (i.e. 30:20). These two ratios indicate that Nigeria possesses a 100 percentage advantage over Ghana for computers, but only a 50 percentage advantage for automobiles. Consequently, Nigeria has a greater relative advantage for the computer products. Therefore, Nigeria should specialize in producing computer products. While Ghana having the least comparative disadvantage in automobiles indicates that it should make and import automobiles.

3.4 **Factor Endowment Theory**

The principles of absolute and relative advantage provide a primary basis for trade to occur, but the usefulness of these principles is limited by their assumptions. One basic assumption is that the advantage, whether absolute or relative, is solely determined by labour in terms of time and cost. Labour then determines comparative production costs and subsequently product prices for the same commodity.

However, if labour is indeed the only factor of production or even a major determinant of product content, then countries with high labour cost should be in serious trouble.

It is misleading to analyse labour costs without also considering the quality of that labour. A country may have high labour cost on an absolute basis, yet this cost can be relatively low if productivity is high. Furthermore, the price of a product is not necessarily determined by the amount of labour it embodies, regardless of whether the efficiency of labour is an issue or not. Since product price is not determined by labour efficiency alone, other factors of production must be taken into consideration, including land and capital.

In conclusion, since countries have different factor endowments, a country would have a relative advantage in a commodity that embodies in some degree that country's comparatively abundant factors. A country should thus export that commodity that is relatively plentiful within the relatively abundant factor.

It should be noted that there are other theories such as production life cycle, Leentief paradox and so forth that you can read on your own.

3.5 Limitations

In sum, trade theories provide layout explanations about why nation's trade with one another, but such theories are limited by their underlying assumptions. Most of the world's trade rules are based on a traditional model that assumes that:

1. Trade bilateral
2. Trade involves products originating primarily in the exporting country
3. The exporting country has a comparative advantage , and
4. Competition primarily focuses on the importing country's market.

However, today's realities are quite different, namely:

1. Trade is a multilateral process
2. Trade is often based on products assembled from components that are produced in various countries
3. It is not easy to determine a country's comparative advantage as evidenced by the countries that often export and import the same product, and

4. Competition usually extends beyond the importing country to include the exporting country and the third countries.

Self Assessment Exercise

State three limitations of theories of international trade

4.0 Conclusion

For countries to want to trade with one another, they must be better of with trade than without it. The principles of absolute and relative advantage explained how trade enables trading nations to increase their welfare through specialization. Trade of products with the best potential fir its own consumption as well as for export. Trade theories, in spite of their usefulness, simply explain what nations should do rather than described what nations actually do.

5.0 Summary

This unit explained basis of trade, and some theories of trade among nations.

6.0 Tutor Marked Assignment

Should there be trade if a country has an absolute advantage for all products over its trading partner?

7.0 References/Further Reading

Adam Smith: 'Wealth of Nations' (1776); Irwin, Homewood, 1963.

David Ricardo: The Principles of Political Economy and Taxation (1817), Penguin, Baltimore, 1971.

Onkvisit Sak and Shaw John, J: International Marketing-Analysis and Strategy, 3rd edition, New Jersey, Prentice-Hall, 19997.

Answers to Self Assessment Exercises

1. Absolute advantage simply means when a country has total advantage on the goods traded in with another country.

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2. Three limitations of international trade theories are:

a. Trade involves products originating primarily in the exporting country
b. The exporting country has a comparative advantage , and
c. Competition primarily focuses on the importing country's market.

UNIT 3: World Business Environment

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1.0 Introduction

Knowledge of world business environment is imperative especially the environment prospective companies want to trade with. Some companies products fail at the world market not because the products are not quality enough, or the target markets do not need them, but they fail to study such environment for their business operations. Some business persons confused the world market environment with home market environment by considering them to be one and the same. This unit examines the world business environmental variables as they affect marketing activities.

2.0 Objectives

After studying through this unit, you should be able to:

2. Explain world business environment

3. Explain the variables at the world business environment, and
4. Explain its marketing implications

3.0 Main Content

3.1 Knowledge of Global Markets

One of the characteristics that distinguish humankind from the rest of the animal kingdom is the ability to devise ways to overcome the harshness of the environment. Geography, the study of earth's surface, climate, continents, countries, people, industries, and resources, is an element of the uncontrollable that confronts every business manager but which receives scant attention. The tendency is to study the aspects of geography as isolated rather than as important causal agents of the business environment.

A significant determinant in shaping the culture of a society and its economy is the on-going struggle to supply its needs within the limits imposed by a nation's physical make-up. Thus, the study of geography is important in the evaluation of business and their environments.

Let examine this example**: '**LACK OF BUSINESSENVIRONMENT KNOLEDGE'

"A major food processing company had production problem after it built a pineapple cannery as the delta of a river in Menico. It built the pineapple plantation upstream and planned to barge the ripe fruit downstream for canning, load them directly on ocean liners, and ship them to the company's various markets. When the pineapples were ripe, however, the company found itself in trouble: crop maturity coincided with the flood stage of the river. The current in the river during the period was far too strong to permit the backhauling of barges upstream; the plan for transporting the fruit on barges could not be implemented. With no alternative means of transport, the company was forced to close the operation."

This case has explained itself, no need for further explanations.

3.2 Demographic Environment

Knowledge of the world business population is pertinent to an international business manager. Markets may exist at the world market, but is the population big enough to break-even, talk less of making profits? Answer must be provided for this question; otherwise going world market is nothing but visitation.

Knowing the gross population is not even enough to an international business manager. For the manager to efficiently plan and implement good marketing programmes, the population has to be broken down into geographical distribution, density, mobility trends, age distribution, birth and death rates, and marriage rates. The international business manager that carefully considers and understands the components of the demographic environment will likely performs a better marketing job than the one that jumps into the market with the assumption that the markets are the same with the home market.

3.3 Natural Environment

By nature, some countries are endowed with natural resources such as oil, sand, water, minerals, mountains, rivers, streams, and so forth than the others. While some countries, who are less blessed with these natural resources, create these artificially to their own advantage. It therefore calls for critical study of these resources as impetus for world Business opportunities and threats.

3.4 Political-Legal Environment

Business decisions are strongly affected by developments in the political and legal environment. This environment is composed of laws, policies, government agencies, regulations, and pressure groups that influence and limit various organizations and individuals. Sometimes, these laws create new opportunities for business, and as well as threats which must be critically studied most especially for those business executives who desire to engage in international business.

To assess a potential business environment, an international business manager should identify and evaluate the relevant indicators of political difficulty. Potential sources of political complication include social unrest, the attitude of nations, and the policies of the host government.

Much like the political environment explained above, there are multiplicities of laws that international managers must content with. These include:

a. Varying laws of nations
b. Bribery and corruption
c. Exchange rate policies
d. Profits repatriation issues
e. Issues of employment at the subsidiaries/branches

f. Intellectual property rights, and so forth.

3.5 Socio-Cultural Environment

The society in which people grew up shapes their beliefs, values, and norms. Culture, an inclusive term can be conceptualized in many different ways. The concept is often accomplished by numerous definitions. In any case, a good basic definition of the concept is that ‘culture’ is a set of traditional beliefs and values that are transmitted and shared in a given society. Culture is also the total way of life and thinking patterns that are passed from generation to generation. Culture means many things to many people, because the concept encompasses norms, values, customs, art, and mores. Therefore, a worldwide business success requires a respect for local customs.

For example, consumption patterns, living styles and the priority of needs are all dictated by culture. In addition to consumption habits, thinking processes are also affected by culture. Food preparation methods are also dictated by culture preferences. For instance, Asian consumers’ prefer their chicken broiled or boiled rather than fried. Consequently, the Chinese in Hong Kong found American –style fried chicken foreign and distasteful. Cultural universals, when they exist, should not be interpreted as meaning that the two cultures are very much alike. Too often, cultural similarities at first glance may in fact be just an illusion. Thus, an international business manager must therefore guard against taking such markets for granted.

Self Assessment Exercise

Gives examples of political-legal laws as it affect international business

3.6 Technological Environment

One of the most dramatic forces shaping people’s lives is technology. The pace of technological development among nations are not the same, thus, an international business manager must study each nation’s technological development independently. Some of the issues, he/she must content with include:

a. Mode of production of goods and services
b. Mode of delivery of services

c. Packaging systems
d. Mode of payments
e. Time consideration
f. Availability of expected technology
g. Cost of technology, and
h. Accessibility of technology.

3.7 Economic Environment

Markets requires purchasing power as wells as people. The availability of purchasing power in an economy depends on current income, prices of goods and services, savings, debt and credit availability. Thus, an international business manager must pay close attention to major trends in income and consumers' spending patterns, in addition to economic situation of the world markets.

Self Assessment Exercise

Does culture influence mode of consumption?

4.0 Conclusion

A complete and thorough appreciation of the dimensions of world business environment may well be the single most important gain to a foreign market. Necessary marketing research need to be carried out into world business culture, political-legal system, technological advancement and so forth.

5.0 Summary

In this unit, you learned about world market environment as it affect international marketing activities.

6.0 Tutor Marked Assignment

Why should a foreign business manager be concerned with the study of culture?

7.0 References/Further Reading:

Eze, B.I (1999) International Marketing, Bauchi, ATBU, 1999 (Unpublished)

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Strategy, 3RD Edition, New Jersey, Prentice-Hall

Answers to Self Assessment Exercises

1. Examples of political-legal laws are:
   a. Varying laws of nations
   b. Bribery and corruption
   c. Exchange rate policies
   d. Profits repatriation issues
   e. Issues of employment at the subsidiaries/branches and
   f. Intellectual property rights, and so forth.

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2. Culture is a set of traditional beliefs and values that are transmitted and shared in a given society. Culture is also the total way of life and thinking patterns that are passed from generation to generation. Culture means many things to many people, because the concept encompasses norms, values, customs, art, and mores. Consumption patterns, living styles and the priority of needs are all dictated by culture. In addition to consumption habits, thinking processes are also affected by culture. Food preparation methods are also dictated by culture preferences.

UNIT4: Globalization

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1.0 Introduction:

We are in the world economy where business activities are being carried out with ease. People no longer travel distances before carrying out their business activities. Goods and services of other Nations are easily made available as demand. This is because there is a fundamental shift in the world of economy trade. We are moving away from a world in which national economies were relatively self contained entities, isolated from each other by barriers to cross- border trade and investment, by distance, culture and business systems. And we are moving towards a world in which barriers to cross border trade and investment are declining; perceived distance is shrinking due to advances in transportation and telecommunications technology, material culture is starting to look similar the world over; and national economies are merging into an inter dependent, integrated global economy system. The process by which this is occurring is commonly referred to as globalization.

People are no longer threat by the four – walls of a nation policy. Business activities and opportunities are widening as a result of globalization. This is the world we live. It is a world where the volume of goods, services and investment crossing national borders has expanded faster than world output consistently for more tham half a century. For businesses, this process has produced many opportunities. Firms can expand their revenues by selling around the world and reduce their costs by producing in nations where key inputs, including labour are cheap. This unit examined the benefits and short-comings of globalization on business activities, world – over.

2.0 Objectives:

On successful completion of this unit, you should be able to:

a. Define globalization
b. Itemize benefits of globalization
c. List the short coming of globalization
d. Mention drivers of globalization

3.0 Main Text:

3.1 Globalization:

During 1920s and 1930s, many of the nation-states of the world erected formidable barriers to international trade and investment. Many of these barriers took the form of high tariffs on imports of manufactured goods. The typical aim of such tariffs was to protect domestic industries from foreign competition. However, after World War II, the advanced industrial nations of the west, under U.S leaderships committed themselves to the good of removing barriers to the free flow of goods, services and capital between nation. The goal of removing barriers to the free – flow of goods was enshrined in the treaty known as General agreement on Tariffs and trade (GATT) under the umbrella of GATT, there has been a significant lowering of barriers to free – flow of goods in the half- century since world war II. Extension has been made recently on GATT to include services. Hence, many countries have been progressively removing restrictions on capital inflows and outflows.

These trends facilitate both the globalization of markets and globalization of production. The process by which this occurs is commonly referred to as globalization. Thus globalization then refers to the shift towards a more integrated and interdependent world economy. Globalization has several faects such as markets, production, etc. Foe example, IKEA is a Sweden global retailer. IKEA's target market is global middle class, who are looking for low-priced but attractively designed furniture and household items. The company applies the same basic formula world – wide. Despite its standard formula, to achieve success, IKEA had to adopt its offerings to the tastes and preferences of consumers in different nations.

3.1a. The globalization of markets

The globalization of markets refers to the merging of distinct and separate national markets into one – huge global marketplace. In this situation, the tastes and preferences of consumers in different nations are beginning to converge on some global norm. Therefore, it is no longer meaningful to talk about the German market, the American market or the Japanese market. All these markets are looked as a single market. For example coca cola company is most part of the world producing and selling soft-drink as coke even the taste change from one country to another.

It should however be noted that a company does not have to be the size of these multinational giants such as coca- cola, Sony, Kodak, etc. to facilitate, and benefit from the globalization of markets. The most global markets currently are not markets for consumer products – where national differences in tastes and preferences are still often important enough to act as a brake on globalization, but markets for industrial goods and materials that serve a universal need the world over. These include the markets for commodities, such as aluminum, oil and wheat for industrial products such as microprocessors.

In global markets, the same firms frequently confront each other as competitors in nation after nation. For example, coca-cola's rivalry with Pepsi cola, just as Ford and Toyota. As firms follow each other around the world, they bring with them many of the assets that served them well in other national markets – including their products, operating strategies, marketing strategies and brand names-creating some homogeneity across markets. Hence, greater uniformity replaces drivers.

3.1b The Globalization of Production:

The globalization of production refers to the sourcing of goods and services from locations around the globe to take advantage of national differences in the cost and quality of factors of production (Land, Labour, capital etc). By so doing these companies hope to lower their overall cost structure or improve the quality of functionality of their product offering, thereby allowing them to compete more effectively.

For example, Lenovo Thinkpad laptop computer . Lenovo a Chiness company, acquired Ibm’s personal computer operations in 2005. The thinkpad is designed in United States because Lenovo believes that the country is the best location in the world to do the basic design work. However, keyboard and hard drive are made in Thailand; the display screen and memory in South Korea; the built in wireless card in Malaysia; and the Micro processor in the United States. In deciding on where to manufacture each component, Lenovo assessed both the production and transportation costs involved in each location. These components were then shipped to a plant in mexico, where the product is assembled before being shipped to the united States for final sale.

Lenovo located located the assembly of the thinkpad in Mexico, because of low labour costs in the country. The marketing and sales strategy for North America was developed in the United states, primarily because Lenovo believes that U.S personel possess better knowledge of local market place than people based elsewhere. It is also important to note that globalization of production is not limited to large firms like coca – cola, Pepsi – cola, general motors, Toyota. It also applies to other smaller firms, who are willing to take advantage of opportunities offered by globalization.

Self- Assessment Exercise

Briefly define globalization.

3.2 Benefits of globalization:

The question is: Is the shift towards a more integrated and interdependent global economy a good thing? Many influential economists, politicians and business leaders seem to think so. They argued that falling barriers to international trade and investment are the twin – engines driving the global economy towards greater prosperity.

1. They believe that globalization stimulates economic growth raises the income of consumers and helps to create jobs in all countries that participate in the global trading system.
2. The lowering of trade barriers enables firms to view the world as a market. This therefore enables firms to based individual production activities at the optimal location for that activity, serving the world market from that location. Thus a firm might design a product in one country , produce component parts in two other countries , assemble the product in yet another country and then export the finished product around the world; a case study of Lenovo company mentioned earlier.

3.2 Short – comings of Globalization:

The anti-globalization protesters are of the views that globalization of the world market has adverse effects on the individuals and nations. They argued that:

1. The following barriers to international trade destroy manufacturing jobs in wealthy advanced economies such as United States and the United Kingdom. The critics ague that falling trade barriers allow firms to move manufacturing activities to countries where wages rates are much lower. For example in the case of Lenovo company, Thinkpad was produced in Mexico because of low labour costs. This is exactly the Chinese companies do in Nigeria. They relocate their plant to Nigeria, especially on production of CDS, electrical cables, etc where it has been established that cost of production is much lower than in China. Hence, selling such products lower than Nigeria made products. Even though, the quality of Nigerian company's products were much superior, consumers still prefer Chinese products.
2. Free trade encourages firm's advanced nations to move manufacturing facilities to less developed countries that lack adequate regulations to protect labour and the environment from abuse by the unscrupulous. This is the case

in Nigeria where Lebanese, Chinese and India companies hired Nigeria – middle class and lower class labourer much more lower than the amount / wages paid by Nigeria's companies. Simply because of some defeats in Nigeria's International laws and policies. Globalization critics often argued that adhering to labour and environment regulations, significally increases the costs of manufacturing enterprises and puts them at a competitive disadvantage in the global market place visa a vis, firms based in developing nations that do not have to comply with such regulations. They therefore suggest that free trade would lead to an increase in pollution and result in firms from advanced nations exploiting the labour less developed nations.

3. Another concern of the critics of globalization is that today's increasingly interdependent global economy, shifts economic power away from national governments and toward super national organizations such as the world trade organization, the European union, and the united Nations. They argued that unelected bureaucrats now impose policies on the democratically elected governments of nation states, thereby under-mining the sovereignty of those and limiting the nations ability to control its own destiny, Nigeria a case study.
4. Critics of globalization argue that despite the supposed benefits associated, with free trade and investment, over the past hundred years or so, the gap between the rich and the poor nations of the world has gotten wider. Critics argue that if globalization is such a positive development this divergence between the rich and the poor should not have occurred.

Drivers of Globalization

Globalization does not just appear on its own there are some factors / innovations which facilitated its application. This unit take a look at some of the innovations which took place and which contributed towards globalization reality.

(a) Declining Trade and Investment Barriers:

During the 1920s and 30s many of the worlds nation – states erected formidable barriers to international trade and foreign direct investment.

However, after World War, the advanced industrial nations of the west committed themselves to removing barriers to the free – flow of goods services and capital between nations. In addition, to reducing trade barriers, many countries have also been progressively removing restrictions to foreign direct investments. Such trends have been driving both the globalization of markets and the globalization of production. (The evidence also suggests that foreign direct investment is playing an increasing role in the global economy as firms increase their cross -border investments).

(b) The role of Technological change:

The lowering of trade barriers made globalization of markets and production a theoretical possibility, but technological change made it a tangible reality. Since the end of World War Ii, the world has witnessed major advances in communication, information processing, and transportation technology, including the explosive emergence of the internet and world wide web. Telecommunication is creating a global audience and transportation is creating a global village.

Implications of globalization of production and markets are:

1. As transportation costs associated with the globalization of production declined, dispersal of production to geographically separate locations become more economical. As a result of the technological innovations, the real costs of information processing and communication would be falling, thus make it possible for firms to create and then manage a global dispersed production system.
2. In addition, technological innovations would facilitate the globalization of markets. Low – cost global communization such as the World Wide Web would help to create electronic global market places.

Self Assessment Exercise

State drivers of globalization system

4.0 Conclusion:

An international business is any firm that engages in international trade or investment. The mode of handling international business is capsaicin due to changes Iin the global economy. That is we are moving away from economic system in which national markets are distinct entities, isolated from each other by trade barriers and barriers of distance, time and culture, and toward a system in which national markets are merging into one huge global marketplace. Thus, the tastes and preferences of consumers in different nations are beginning to coverage on some norms.

5.0 Summary:

This unit discussed globalization system as it affects domestic and informational trade. It looks into globalization of markets and production, the drivers of globalization and its implications global production and markets.

6.0 Tutor Marked Assignment

Briefly explain two (2) implications of Globalization.

7.0 References / Further Readings

Charles W.L It (2008) Global Business Today 5th Edition, McGraw-Hill/, New York Irwin

Charles, W.L. H. (1994) International Business – Competing in the Global Marketplace, 2nd Edition, Trwin: Australia

James, G (2004) “T he Winners and the Loses” in the case against the global Economy, New York: Time Warner Books.

Answers to self Assessment Exercises

1 Globalization simply means the remove of restrictions on trade activities among nations and individuals, which was facilitated by modern communications.

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2 Drivers of globalization are:

a) Declining Trade and Investment Barriers:

During the 1920s and 30s many of the worlds nation – states erected formidable barriers to international trade and foreign direct investment. However, after World War, the advanced industrial nations of the west committed themselves to removing barriers to the free – flow of goods services and capital between nations. In addition, to reducing trade barriers, many countries have also been progressively removing restrictions to foreign direct investments. Such trends have been driving both the globalization of markets and the globalization of production. (The evidence also suggests that foreign direct investment is playing an increasing role in the global economy as firms increase their cross -border investments).

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Unit 5: Foreign Direct Investment (FDI)

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1.0 Introduction:

The breakthrough in modern technological advancements have made both domestic and international business much easier than before. The innovations in tele communication and transportation system, such World Wide Web, internet, jets, Railways etc has turn the whole world into a global village. Business executives are no-longer limited to their own business environment, there are also concerned about international environment. This is because they can invest in the international business as obtainable at home. While achieving this they partake in foriengn direct investment. Foreign direct investment (FDI) occur when a firm invests directly in new facilities to produce a product ina foreign country or it may occur when a firm buys an existing enterprise in a foreign country. This unit defined foreign direct investment, the aims of foreign direct investment and examining some theories of foreign direct investment.

2.0 Objectives:

On successful completion of this unit, you should be able to:

a. Describe foreign direct Investment (DI)
b. Give reasons for foreign direct Investment
c. Example two theories of FDI
d. State benefits of F.D.I

3.0 Main Text:

3.1 Foreign direct Investment (FDI) occurs when a firm invests directly in facilities to produce or market a product in a foreign country. According to the U>S Department of Commerce, FDI occurs whenever a U.S citizen, organization or affiliated group takes an interest of 10 percent or more in a foreign business entity. Once a firm undertakes FDI, it becomes a multinational enterprise. FDI is classified into two:

1. Foreign direct Investment (FDI) occurs when a firm invests directly in facilities to produce or market a product in a foreign country.. It is important to note that the flow of FDI refers to the amount of FDI undertaken over a given period (usually a year). While the stock of FDI refers to the total accumulated value of foreign-owned assets at a given time.

Self Assessment Exercise

a. Define Foreign Direct Investment
b. Briefly explain the two types of FDI.

FDI Starbucks Experience:

For you to understand the application of FDI in practice, starbucks experience is cited below. Thirty years ago, starbucks was a single store in Seattle's pike place marketing , selling premium roasted coffee. Today, it is a global roaster and retailer of coffee with over 11,300 stores, more than 3,300 of which are to be found in 37 foreign countries. Starbucks corporation set out or its current course in the 1980s when the company's director of marketing- Howard Schalte, came back from a trip to Italy, enchanted, with the Italian coffee house experience. Schultz, who later became CEO, persuaded the company's owner to experiment with the coffeehouse experience. Schultz, who later became CEO, persuaded the company's owners to experiment with the Coffeehouse format and the Star Bucks experience was born. The strategy was to sell the company's own premium roasted Coffee and Freshly brewed express-o style coffee beverages, along with a variety of pastries, coffee accessories, teas and other products in a tastefully designed coffeehouse setting, etc.

By 1995, with 700 stores across the United States, Star bucks began exploring foreign opportunities. It first target market was Japan. The company established a joint venture with a local retailer, Sazaby Inc. Each company held a 50 per cent stake in the venture, star buck coffee of Japan. Star bucks initially $10 million in this venture, the first licensed to the venture which was charged with taking over responsibility for growing star bucks presence in Japan

After Japan, the company embarked on an aggressive foreign investment program. By 1998, it purchased Seathe Coffee, a British Coffee chain with 60 retails for $84 million. By 2002, Starbucks was pursuing an aggressive expansion in mainland Europe. As at its first entry, the company choose Surtzerland. Drawing on its experience in Asia, the company entered into a joint venture with a Swiss company, Bon Appretit Group, Switzerland's largest food service company. Bon Appetit was to hold a majority stake in the venture, and star bucks would license its format to the Swiss company using a similar agreement to those it had used successfully in Asia. This was followed by a joint venture in other countries.

Source: Charles, W. L. H (2008) Global Business Today, 5th Edition, New York : McGraw-Hill, PP. 223-228

Charles (2008) reports that the past 30 years have seen a marked increase in both the flow and stock of FDI in the world economy. The average yearly outflow of FDI increase from $25 billion in 1975 to a record of $1.2 trillion by 2000.

FDI has grown more rapidly than world trade and world output for several reasons, namely:

1. Despite the general decline in trade barriers over the past 30 years, business firms still fear protagonist pressures. Business executives see FDI as a way of circumventing future trade barriers.

2. Much of the recent increase in FDI is being driven by the political and economic changes that have been occurring in many of the world's developing nations.

3. The globalization of the world economy is also having a positive impact on the volume of FDI. Firms such as Star bucks now see the whole world as their market and they are undertaking FDI in a attempt to make sure they have a significant presence in many regions of the world.

3.2 Form of Foreign Direct Investment (FDI)

FDI can take the form of a Greenfield investment in a new facility or an acquisition of or a merger with an existing local firm. However, most of cross-border investment is in the form of mergers and acquisitions, rather than Greenfield investment. Some of the reasons why forms prefer acquisition or merger instead of Greenfield are given below:

I. Mergers and acquisitions are quicker to execute than Greenfield investment. This is an important consideration in the modern business world, where markets evolve vary rapidly. Many firms apparently believe that if they fail to acquire a desirable target of the firms; then global rivals will.

II. Foreign firms are acquired because those firms have valuable strategic assets, such as brand loyalty, customer relationships, trade marks or patents, distribution systems production systems and so on. It is believe that it is (easier and perhaps less risky) to acquire those assets than to build them afresh through a Greenfield investment.

III. Firms make acquisition as the favourable choice because they can increase the efficiency of the acquired unit of transferring capital, technology or management skills.

3.3 Why do Acquisition Fail?

Acquisition fails for several reasons:

I. The acquiring firms often overpay for the assets of the acquired firm. The price of the target firm can get bid up if more than one firm is interested in its purchase; this is the case of NITEL and Nigeria Sugar Company Bachita..Besides, the management of the acquiring firm is often too optimistic about the value that can be created via an acquisition and is thus willi9ng to may a significant premium over a target firm's market capitalization. This is called the Hubris hypothesis of why acquisitions fail. The Hubris hypothesis postulates that managers typically overestimate their ability to create value from an acquisition, primarily because rising to the top of a corporation has given them as exaggerated sense of their own capabilities.

II. Many acquisitions fail because there is a clash between the cultures of the acquiring and acquired firm. After acquisition, many acquired companies experience high management turnover, possibly because their employees do not like the acquiring company's ways of doing things; the is exactly what happened to NITEL plc

III. Many acquisitions fail because attempts to realize synergies by integrating the operations of the acquired and acquiring entities often run into roadblocks/problems, and take much longer than forecast. Differences in management philosophy and company culture can slow the integration of organizations. This what happened to mergers of banks in Nigeria, and some insurance firms. For example, Afribank and Union bank plc were seriously affected due to changed of leadership. Besides, differences in national culture may exacerbate these problems. Bureaucratic haggling between managers also complicates the process.

IV. Many acquisitions fail due to inadequate pre-acquisition screening. Many firms decide to acquire other firms without thoroughly analyzing the potential benefits and costs. They often more with undue haste to execute the acquisition, perhaps because they fear another competitor may pre-empt. After the acquisition, many acquiring firms discovered that instead of buying a well run business, they have purchased troubled organization.

Self Assessment Exercise

What are the factors responsible for the growth of FDI?

3.4 Greenfield Investment/Venture

Many firms still prefer Greenfield investments despite the numerous advantages of merger acquisitions. The arguments for such decisions are:

Establishing a Greenfield venture in a foreign country is that it gives the firm a much greater ability to build the kind of subsidiary company its wants. For example, it is easier to build an organization culture of an acquired unit. Similarly, it is easier to establish a set of operating routines in a new subsidiary than to convert the operating routines of acquired unit.

This is a vary important advantage for many international businesses, where transferring products, competencies, skills and knew-how from the established operations of the firms to the new subsidiary are principal ways of creating value. For example, when Lincoln

Electric, the U.S manufacturer of arc welding equipment, first ventured overseas in the mid-1980, it did so by acquisitions, purchasing arc welding equipment companies in Europe.

However, Lincoln’s competitive advantage in the United States was based on a strong organizational and unique set of incentives that encouraged its employees to everything possible to increase productivity. Lincoln found though hilted experience that it was almost impossible to transfer its organizational culture and incentives to acquired firms, which had their own distinct organizational culture and incentives. As a result, the firm switched its entry strategy in the mid-1990s and began to enter foreign countries by establishing Greenfield ventures, building operations from the group up.

Disadvantages of Greenfield Venture

Greenfield ventures are slower to established . They are also risky. There is also a possibility of being pre-empted by more aggressive global competitors that enter via acquisitions, and build a big market presence that limits the market potential for the Greenfield venture.

In conclusion, the choice between making an acquisition or establishing a Greenfield venture is not an easy one. Both modes have their advantages and disadvantages. In general, the choices will depend on the circumstances confronting the firm. If the firm is seeking to enter a market in which enterprises and in which global competitors are also interested in establishing a presence, acquisition may be the better mode of entry. In such situations, a Greenfield venture may be too slow to establish a sizeable presence. However, if the firm is going to make an acquisition its management should be cognizant of the risks discussed earlier.

On the other hand, if the firm is considering entering a country in which there are no incumbent competitors to be acquired, then a green field ventures may be the only viable mode. Even when incumbents exists, if the competitive advantage of the firm is based on the transfer of organizationally embedded competencies, skills, routines and culture, it may still be preferable to enter via a Greenfield venture.

3.5 Reasons for Foreign Direct Investment

One may wonder why firms take the trouble of establishing operations abroad through foreign direct investment when there are alternatives of entering and licensing their goods. Exporting involves producing goods at home and then shipped them to the receiving country for sale. While licensing involves granting a foreign entity the right to produce and sell the firm's product in return for a royalty fee on every unit sold. If that be the case, then why do firms apparently prefer FDI over either exporting or licensing. This will be address from the limitations of exporting and licensing as means for capitalizing on foreign market opportunities.

A. Limitations of Exporting

The viability of an exporting strategy is often constrained by transportation costs and trade barriers. When transportation costs are added to production costs, it becomes unprofitable to ship some products over a long distance. This applies to products with low value do weight ratio and that can be produced in almost any location. For example, cement. Soft-drink, etc. For such products, the attractiveness of exporting decreases relative to either FDI or licensing. In addition, for products with high value -to-weight ratio, transportation costs are normally a minor component total landed cost. For example, electronic components, personal computers, medical equipment, computer soft wares, etc, they have little impact on the relative alternatives of exporting, licensing and FDI

Some firms undertake foreign direct investment as a response to actual or threatened trade barriers such as import tariffs or quotas. By placing tariffs on imported goods, governments can increase the cost of exporting relative to foreign direct investment and licensing. In addition, by limiting imports through quotas, governments increase the attractiveness of FDI and licensing. For example, the wave of FDI by Japanese auto-companies in the United States during the 1980s and 1990s was partly driven by protection of Japanese congress and by quotas on the importation of Japanese cars. These factors decreased the profitability of exporting and increased that of foreign direct investment. It should however be noted that trade barriers do not have to be physically in place for FDI to be favoured over exporting.

B. Limitations of Licensing

The international business theory of foreign direct investment seeks to explain why firms often prefer foreign direct investment over licensing as a strategy for entering foreign market. This theory states that licensing has three major drawbacks as a strategy for exporting foreign market opportunities. These are:

1. Licensing may result in a firm's giving valuable technological know-how to a potential foreign competitor (for example-during 1960s, RCA licensed its leading Matsushita and Sony. At the time, RCA saw licensing as a way to earn a good return from its technological know-how in the Japanese market without the costs and risks associated with foreign direct investment. However, Mutsuhito and Sony quickly assimilated RCA's technology and used it to enter the U.A. market to compete directly against RCA. Hence, RCA is now a minor player in its home market while Mutsuhito and Sony have a much bigger market share)
2. That licensing does not give a firm the tight control over manufacturing, marketing and strategy in a foreign country that may be required to maximizes its profitability
3. That licensing arises when the firms competitive advantage is based not as much as its products as on the management, marketing, and manufacturing capabilities that produce these products. The problem here is that such capabilities are often not amendable to licensing.

3.6 Theories of Foreign Direct Investment (FDI)

There are so many theories underlying FDI, but fe are considered below:

a. The product Life Cycle Theory

Raymond Vermon was postulator of this theory. He argued that often times, firms that pioneer a product in their home markets undertake FDI to produce a product for consumption in foreign markets. For example, Xerox introduced the photocopier in the United States, and it was Xerox that set up product facilities in Japan (Fuji-Xerox) and Great Britain (Rank-Xerox) to serve those markets. He argued that firms undertake FDI at particular stages in the life-cycle of a product they have pioneered. They invest in other advanced countries when local demand in those countries grows large enough to developing countries when product standardization and market saturation gave rise to price competition and cost pressures. Investment in developing countries, where labour costs are lower is seen as the best way to reduce costs.

However, the theory fail to explain why it is profitable for a firm to undertake FDI at such times rather continuing to export from its home base or licensing a foreign firm to produce its product. Just because demand in a foreign country is large enough to support local production, it does not necessarily follow that local production is the most profitable option. It may still be more profitable for the firm to produce at home and export to that country. Alternatively, it may be more profitable for the firm to license a foreign country to produce its product for sale in that country. Product life cycle theory ignores these options and instead, simply argues that once a foreign market is large enough to support local production FDI will occur.

b. The Electric Paradigm

This was championed by the British economist, John Dunming. Dunming argues that in addition to the various factors discussed above, location-specific advantages are also of considerable importance in explaining both the rationale for and the direction of foreign direct investment. By location-specific advantages, Dunming means the advantages that arise from utilizing resources endowments that a firm finds valuable to combine with its own unique assets (such as technological capabilities, marketing, or management capabilities).

Dinming accepts the argument of internalization theory that it is difficult for a firm to license its `own unique capabilities location-specific assets or resource endowments with the firm's own unique capabilities often requires foreign direct investment. That is, it requires the firm to establish production facilities, where those foreign assets or resources endowments are located.

The only shortcoming of the theory may be the culture and government policy which may not work in favour of the firm's operations.

c. The Radical View .

The radical view traces its root to Marxist political and economic theory. Radical writers argued that the multinational enterprises (MNEs) is an instrument of imperialist domination. They argued that MNEs are tool for exploiting host countries to be exclusive benefit of their capitalist-imperialist home countries. They stressed that MNEs extract profits from the host country and take them to their home country, giving nothing of value to the host country in exchange.

d. The Free-Market View

The free-market view traced its roots to classical economists and international trade theorists of Adam Smith and David Ricardo. The free market view argues that international production should be distributed among countries according to the theory of comparative advantage. Countries should specialize in the production of those goods and services that they can produce most efficiently. Within this frame work, the MNE is an instrument for dispensing the production of goods and services to the most efficient locations around the globe. Hence, FDI by MNEs increases the overall efficiency of the world economy.

It should however be noted that no country has adopted the free market view in its pure form. Countries such as Great Britain and United States are among the most open to FDI, but the governments of these countries both have still reserved the rights to intervene Britain does so by reserving the right to stop/block foreign take-over's of domestic's firms if the takeovers are seen as "contrary to national security interests" Or if they have the potential for "reducing competitors". .

e. Pragmatic Nationalism

In pragmatic, many countries have adopted neither a radical policy nor a free market policy toward FDI, but instead a policy that can best be described as pragmatic nationalism. The pragmatic nationalist view is that FDI has both benefits and costs. FDI can benefit a host country by bringing capital , skills, technology and jobs, but those benefits come at a cost. When a foreign company rather than a domestic company produces products, the profits from that investment go abroad. Many countries are also concerned that a foreign owned manufacturing plant may import many components for the host country's balance of payments problem.

Recognizing this, countries adopting a pragmatic stance, pursues policies designed to maximize the national benefits and minimize the national costs. Accordingly, foreign direct investment should be allowed so long as the benefits outweigh the costs.

In conclusion. There are other theories of FDI, however, the one to be adopted depend son the business environment and the policy of the firms.

4.0 Conclusion

Business is all about taking risk, the right risks. Choosing which risks to accept and which to avoid is at the heart of management. These risks increase and become more interesting with entry into foreign markets.

5.0 Summary

Business is longer domestic, duly local markets may be inadequate for thr goods produced at home or foreign markets offers better advantage in terms of production costs and sales. Hence, firms look for best way of entering foreign markets. One of such ways is through FDI. This unit examines FDI on thr basis of business implications. Forms of FDI were looked into, benefits of FDI and some theories of FDI were equally looked into.

6.0 Tutor Marked Assignment

Why acquisition does fail?

Answer

Acquisition fails for reasons as:

1. The acquiring firms often overpay for the assets of the acquired firm. The price of the target firm can get bid up if more than one firm is interested in its purchase; this is the case of NITEL and Nigeria Sugar Company Bachita..Besides, the management of the acquiring firm is often too optimistic about the value that can be created via an acquisition and is thus willi9ng to may a significant premium over a target firm's market capitalization. This is called the Hubris hypothesis of why acquisitions fail. The Hubris hypothesis postulates that managers typically overestimate their ability to create value from an acquisition, primarily because rising to the top of a corporation has given them as exaggerated sense of their own capabilities.

2. Many acquisitions fail because there is a clash between the cultures of the acquiring and acquired firm. After acquisition, many acquired companies experience high management turnover, possibly because their employees do not like the acquiring company's ways of doing things; the is exactly what happened to NITEL plc
3. Many acquisitions fail because attempts to realize synergies by integrating the operations of the acquired and acquiring entities often run into roadblocks/problems, and take much longer than forecast. Differences in management philosophy and company culture can slow the integration of organizations. This what happened to mergers of banks in Nigeria, and some insurance firms. For example, Afribank and Union bank plc were seriously affected due to changed of leadership. Besides, differences in national culture may exacerbate these problems. Bureaucratic haggling between managers also complicates the process.
4. Many acquisitions fail due to inadequate pre-acquisition screening. Many firms decide to acquire other firms without thoroughly analyzing the potential benefits and costs. They often more with undue haste to execute the acquisition, perhaps because they fear another competitor may pre-empt. After the acquisition, many acquiring firms discovered that instead of buying a well run business, they have purchased troubled organization.
5.

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Answers to Self Assessment Exercises

a. Foreign direct Investment (FDI) occurs when a firm invests directly in facilities to produce or market a product in a foreign country.
b. Foreign direct Investment (FDI) occurs when a firm invests directly in facilities to produce or market a product in a foreign country.

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2) Factors responsible for the growth of FDI are:

1. Despite the general decline in trade barriers over the past 30 years, business firms still fear protagonist pressures. Business executives see FDI as a way of circumventing future trade barriers.

2. Much of the recent increase in FDI is being driven by the political and economic changes that have been occurring in many of the world's developing nations.

3. The globalization of the world economy is also having a positive impact on the volume of FDI. Firms such as Star bucks now see the whole world as their market and they are undertaking FDI in a attempt to make sure they have a significant presence in many regions of the world.

Unit 6: Political –Economy of International Trade

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1.0 Introduction

The political economy is the study of how political factors influence the functioning of an economic system, such as the international trading system. It describes how political realities have shaped and continue to shape the international trading system. Although many nations are normally committed to free trade; they tend to intervene in international trade to protect the interests of politically important groups or promote the interests of key domestic producers. When governments intervene, they often do so by restricting imports of goods and services into their nation, while adopting policies that promote exports. Normally their motives are to protect domestic producers and jobs from foreign competition while increasing the foreign market for products of domestic producers. This unit concerned itself with political instruments used by government for safeguarding domestic trade against international trade.

2.0 Objectives

On successful completion of this unit, you should be able to:

1. Define political economy
2. Explain instruments of trade policy and
3. Explain political arguments for and against intervention in international business

3.0 Main Text

3.1 Instruments of Trade Policy

Political economy is the study of how political actors influence the functioning of an economic system, such as the international trade. It aim to describe how political realities have shaped and continue to shape the international trade system. Governments adopt various policies to curb cross-border trade. Among these policies is the trade policy. Trade policy concerned itself with instruments that government s used to control in-flow and out-flow of goods within a country. The most common among these instruments are discussed below:

3.1a. Tariffs

Tariffs are the oldest form of trade policy, usually placed on imports of foreign products. They fall into two categories

1. Specific tariffs which are levied as a fixed charged for each unit of a good imported and
2. Ad valorem tariffs are levied as a proportion of the value of the imported good. An example of ad valorem tariffs is the 25 per cent Bush's administration placed on imported on light trucks (Pick up trucks, Four-Wheel-drive vehicles, etc.)

In most cases, tariffs are placed on imports to protect domestic producers from foreign competition by raising the price of imported goods. Tariffs also serves as major source of various nations. The federal republic of Nigeria receives major source of revenue from tariffs on various goods that imported to country. In addition, the U.S government received most of its revenues from tariffs. T he issue of who suffers and who gains in tariffs should be stress here. Governments' gains. This is because the tariff affords them some production against foreign competitors by increasing the cost of imported foreign goods. But the consumers lose. This is because; they must pay for certain imports. For example, in March 2002, the US government placed a valorem tariff of 8 per cent to 30 per cent on imports of foreign steel. The effect was to reduce the price of steel products in the United States between 30 and 50 per cent.

However, by November 2002, the whole trade organization declared that the tariffs represented a violation of the WHO treaty, thus, the United States consequently removed them in December of that year. Nevertheless, two conclusions can be draw from economic analysis of the effect of import tariffs:

a. Tariffs are unambiguously pro-producer and anti consumers. While it protect producers from foreign competitors, this restriction of supply also raises domestic prices. The case of Bush's administration mentioned earlier is a good example.
b. Import-tariffs reduce the overall efficiency of the world economy. They reduce efficiency because a protective tariff encourages domestic firms t produce more efficiently abroad. The consequence is an inefficient utilization of resources. For example the importation of tariff on band of rice , cements, vehicles etc by federal republic of Nigeria. These has made prices of these goods to rise up, hence consumers find it difficult to buy them. In the long-run, it is the citizens of such countries where tariffs are imposed that suffer the consequences.

Self Assessment Exercise

Define Tariffs

3.1b Subsidiaries

A subsidy is a government payment to a domestic producer. Subsidiaries' take many forms, such cash grants, low-interest loans, tax breaks and government equity participation in domestic firms. By lowering production costs, subsidiaries help domestic producers in two ways: a) competing against imports and b) going export markets. Agriculture tends to be one of the largest beneficiaries of subsidiaries in most countries. In 2002, the European Union was paying $43 billion annually in farm subsidiaries. Also in May 2002, President George. W. Bush signed into law a bill that contained subsidiaries of more than $189 billion for US farmers spread out over 10 years. Government of Nigeria has been threatening to go strike any attempt to remove petroleum subsidiary.

Some scholars argued that subsidiaries can help a firm achieve a first move advantage in an emerging industry. If this is achieved, further gains to the domestic economy arise from the employment and tax revenues that a major global company can generate. However, it ids observed that many subsidiaries tend to protect the inefficient and promote excess production. For example, agricultural subsidiaries:

a. Allow inefficient farmers to stay in business
b. Encourage countries to over produce heavily subsidized agricultural products
c. Encourage countries to produce products that could be grown more cheaply elsewhere and imported
d. And therefore reduce international trade in agricultural products.

It has been observed that if advanced countries abandoned subsidiaries to farmers, global trade in agricultural products would be 50 per cent higher and the world as whole would be better off by $160 billion (Anderson, 2000).

3.1c Import Quotas

An import quota is a direct restriction on the quantity of some goods that may be imported into a country. The restriction is usually enforced by issuing import licenses to a group of individuals or firms. For example, US have a quota on cheese imported. The only firms allowed to import cheese are certain trading companies each of which is allocated the right to import a maximum of pounds of cheese each year. Similar situation occurs in Nigeria, it is only Dangote firms that is allowed to import rice and cements,

3.1d Local Content Requirements

A local content requirement is a requirement that some specific fraction of ago be produced domestically. The requirement can be expressed either in physical terms (some per cents) or in value terms. Local content regulations have been widely used by developing countries to shift their manufacturing base from the same/simple assembly of products, whose parts are manufactured elsewhere into the local manufacturer of component parts.

They are used by developed countries to protect local jobs and industry from foreign competition. This is the case of oil and gas industry in Nigeria, where certain per cent of local content is permitted to carried out by the local experts.

3.1e Administrative policies

Administrative trade policies are bureaucratic rules designed to make it difficult for imports to enter a country. A case study here is Japan. Japan's formal tariff and non-tariff barriers have been among the lowest in the world. However, charges the country imposed through administrative barriers to imports are grater than the lowest tariffs incentives. For example, the Netherlands exports tulip bulbs to almost every country in the world except Japan.

3.1f Anti-Dumping Policies

Dumping is defined as selling goods in a foreign market for less than their cost of production or below their market values. Dumping is therefore views as a method by which firms unload excess production in foreign markets. Some dumping may be the result of predatory behavior, with producers using substantial profits from their home markets to subsidize prices in a foreign market with view to drawing indigenous competitors out of that market. Once this has been established, the predatory firm can raise prices and earn substantial profits. This is exactly what Chinese's firms does to Nigeria market with their substandard tires, electrical cables and bulbs and pharmaceutical drugs

Anti-dumping policies are designed to punish foreign firms that engage in dumping. The ultimate objective is to protect domestic producers from unfair foreign competitions.

3.2 Political Argument for Trade Intervention

Some of the political arguments for trade intervention are explained below:

i. Protecting jobs and industries- Perhaps the most common political argument for government intervention is that this necessary for protecting jobs and industries from unfair competitions. For example, tariffs imposed by George Bush on foreign steels.

ii. National security- Countries sometimes argue that it is equally necssry to protect certain industries because they are important for national security. For example, defense related industries often get this kind of attention, such aerospace, airports and seaports.
iii. Retaliation- A school thought argued that governments should use the threat t intervene in trade policy as a bargaining tool to help open foreign markets and force trading partners to "play by the rules of the game". The US government has used the threat of punitive trade sanctions to try to get Chinese government to enforce its intellectual property laws.
iv. Protecting consumers- Many governments have long had regulations to protect consumers from unsafe products.
v. Protecting human rights- Protecting and promoting human rights in other countries as an important element of foreign policy for many democratic governments. Sometimes, it is use as attempt to improve the human right policies of trading partners.

Self Assessment Exercise

Give any three reasons for political argument for trade interventions

3.3 Economic Arguments for Trade Intervention

With the development of the new trade theory and strategic trade policy, the economic arguments for government intervention have undergone a renaissance in recent years. Nevertheless, two arguments will be considered here:

1. The infant industry arguments- The infant industry argument is by far the oldest economic argument for government intervention. Alexander Humitton proposed it in 1972. He argued that many developing countries have a potential comparative advantage in manufacturing, but new manufacturing industries cannot initially compete with established industries in developed countries. To allow manufacturing to get benefits, the argument is that governments should temporarily support new industries, until they have grown strong enough to meet international competition.

   The argument has had substantial appeal for the governments of developing nations during the past 50 years and the General Agreement on Tariff and Trade

(GATT) has recognized the infant industry argument as a legitimate reason for protectionism.

However, many economists remain critical of this argument for two reasons, namely:

a. Protection of manufacturing firms from foreign competition does no good unless the protection helps to make the industry efficient. Protection seems to have done little more harm to the development of inefficient industries that have little hope of ever competing inn the world market.
b. That firms are unable to make efficient long term investments by borrowing money from the domestic or international capital market. Therefore, governments are required to subsidize long term investments.

II. Strategic Trade policy- The strategic trade policy has two components, these are:

a. It is argued that by appropriate actions, a government can help raise national income.
b. That it might pay a government to intervene in an industry by helping domestic firms overcome the barriers to entry created by foreign firms that have already reaped first mover advantages.

In conclusion, if these arguments are true, then government should target technologies that may be important in the future and use subsidiaries to support development work aimed at commercializing those technologies.

In addition, government should provide export subsidiaries until the domestic firms have established firm-mover advantages in the world market

Government support may also be justified if it can help domestic firms overcome the first-mover advantage as viable competitors in the world market.

4.0 Conclusion

There is no country al over the world that exist without one law, Acts or regulations/sanctions. As good as they may be, they should be oriented towards development of man kinds.

5.0 Summary.

This unit examined the political economic system of a nation as it applies to international business. Various arguments for and against trade intervention were extensively discussed in this unit.

6.0 Tutor Marked Assignment

Give two reasons why economists are critical about economic arguments for trade intervention

Answer:

a. Protection of manufacturing firms from foreign competition does no good unless the protection helps to make the industry efficient. Protection seems to have done little more harm to the development of inefficient industries that have little hope of ever competing inn the world market.
b. That firms are unable to make efficient long term investments by borrowing money from the domestic or international capital market. Therefore, governments are required to subsidize long term investments.

7.0 References/Further Readings

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Answers to Self Assessment Exercises

1 Tariffs are the oldest form of trade policy, usually placed on imports of foreign products. They fall into two categories

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b. Ad valorem tariffs are levied as a proportion of the value of the imported good. An example of ad valorem tariffs is the 25 per cent Bush's administration placed on imported on light trucks (Pick up trucks, Four-Wheel-drive vehicles, etc.)

Three political arguments for trade intervention are:

a. Protecting jobs and industries- Perhaps the most common political argument for government intervention is that this necessary for protecting jobs and industries from unfair competitions. For example, tariffs imposed by George Bush on foreign steels.
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c. Retaliation- A school thought argued that governments should use the threat t intervene in trade policy as a bargaining tool to help open foreign markets and force trading partners to “play by the rules of the game”. The US government has used the threat of punitive trade sanctions to try to get Chinese government to enforce its intellectual property laws.

UNIT 7: Mode of Entering International Markets

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1.0: Introduction

Marketing opportunities exist in all countries regardless of the level of economic development. To assume that only developed countries offer more market potential is a misconception that wills lead international business manager astray. A particular market may initially seem attractive because of its potential demand and size in terms of the number of consumers or their purchasing power. Yet the market may be attracting more than its share of competition. Since the market is thus crowded by many competitors, it may not be especially attractive after all. As a result, Onkvisit and Shaw (1997) observed that LDCs may provide a better return on investment because competitive expenditures can be significantly less when sophisticated and expensive marketing techniques are not necessary.

A business manager usually discerns far more market opportunities that a firm's limited resources permit to be pursued. It therefore implies that a marketer must develop a priority system so that available resources will not be spread too thin for the needed impact. Countries must be screened based on certain relevant criteria for comparing opportunities. Such criteria may include market potential, economic growth, political risk, available resources, etc. In assessing market opportunities, there is no single ideal criterion. A marketer must therefore employ a set of criteria that is relevant to the market opportunity under consideration. This unit examines the various alternatives of entering international markets.

2.0 Objectives

After thorough study of this unit, you should be able to:

1. Explain modes of entering international markets
2. Select the best option for your business and
3. Advise clients on the modality of approaching an international market.

3.0 Main Content

3.1 International Business Entry Decision

Once a company has analyzed the environment of foreign market and concludes that it represents an alternative opportunity, the next step for the company is to take strategic decisions on how to enter the market. A company that has this kind of decision to make usually have three strategic options to consider and select the most appropriate. In trying to select the most appropriate strategic option, the company has to consider the impact of some the crucial factors such as the nature of the product, nature of the market, financial capacity of the company, the management expertise, and the established objectives of the company. These options are thus discussed below.

3.2 Export

This is the quickest and simplest way through which a company can enter foreign markets. With the option, the manufacturing facilities of the company will remain located in the home country while the company simply makes arrangement on how to sell some of its present products abroad. Exporting is a strategy in which a company, without any marketing or production or organization overseas, exports a product from its home base market abroad.

Exporting allows a company to enter foreign markets with a minimum of change in its product line, company organization, investment, or company mission.

The main advantage of exporting strategy is the case in implementing the strategy. Risks are minimal because the company simply exports its excess production capacity when it receives orders from abroad. The problem with using an exporting strategy is that it is not always an optimal strategy. A desire to keep international activities simple, together with a lack of product modification, make a company's marketing strategy inflexible and unresponsive.

However, any company that chooses to enter into international markets by only exporting its products to the foreign markets can achieve the objective through two ways, namely indirect export and direct export.

3.2:1 Indirect Export

Under this method or strategy, the firm does not have to develop an oversea sale force. It will only hire independent international middlemen in the countries concerned. Firms that are stating export business for the first time usually adopt this method. The method involve less investment and less risks. The assumption is that the middlemen's established goodwill, marketing know-how and services will enable the image of the product and possibly increase the speed of its acceptance in the market.

Firms that adopt the indirect export method in their international business usually have three options of domestic middlemen arrangements. They can use any or combination of the following:

(a): Domestic Based Export Merchants

Buys the manufacturers' products and then sell them abroad. With this arrangement, the exporting company only sells its products to the export merchant in the home country. After buying from the company, the export merchant will then sell the product to foreign markets on its own account. Because, the merchant takes title to the product, it shoulders all the burden and risks involved in exporting the product to foreign markets.

(b): Domestic-Based Export Agents

The agents seek and negotiate foreign purchases and are paid commissions. The agents simply agree to seek for foreign buyers for the company. Their job normally is to bring foreign buyers into contact with domestic sellers. They receive commission on any business done. However, the exporting firm will bear the whole risk involved in the business. In selecting the agent to work with, the exporting company has the option of choosing any of the following:

i. Export Buying Agents.

They reside in the manufacturer's country but represents foreign buyers. Their functions are to place orders with the manufacturers, take care of the

ii. Brokers

Their function is only to find buyers for the manufacturer. They do not handle the product.

iii. Manufacturers' Export Agents

These agents represent many manufacturers with non-competing interests. They render selling and other marketing services to the manufacturers.

(c) Cooperative Organization

The cooperative organizations serve many producers with non-competing interests by making careful plans on how to export the products on their behalf. Although, the cooperative organization is independent, it is not wholly independent as the producers have a remarkable influence on the administrative control of its activities.

3.2:2 Direct Exports

The manufacturers concerned take responsibility of exporting their products instead of using the services of middlemen. However, not all the manufacturers can enter through this method. The method is often employed by big manufacturers with enough quality of products to sell to and by those whose market has grown to sufficient size to justify the burdens involved in it, for example the Coca-Cola Company.

Although, the method has a high probability of yielding a profitable return, the level of investment and risk associated with it is usually high. Notwithstanding, manufacturers that use this method as their entry strategy into international markets, can adopt any of the following options:

a**). Domestic-Based Export Department:** An export sale manager carries on the actual selling and draws on market assistance as needed. The department might evolve into a self-contained export department performing all the activities to export and operating as a profit centre.

b). Overseas Sales Branch or Subsidiary: An overseas sales branch allows the manufacturer to achieve greater presence and program control in the foreign market. The sales branch handles sales and distribution and might handle warehousing and promotion as well. It often serves as a display and customer service centre also.

c). Traveling Export Sales Representatives: The manufacturers concerned usually send one or two of their home-based sales representatives to foreign markets to canvas for business and possibly get orders from buyers. This strategy is often employed by big companies that are entering into a market newly and by small companies with financial handicap.

d). Foreign-Based Distributors or Agents: The company can hire foreign-based distributors or agents to sell the company's goods. These distributors and agents might be given exclusive rights to represent the manufacturer in that company or only limited rights.

3.3 Joint Venturing

Foreign investors may join with local investors to create a joint venture in which they share ownership and control. That is, companies that adopt this method as their entry strategy into foreign market join hands with the nationals in the foreign countries to set up production and marketing facilities abroad. For example, Kotler (1997) reported that

Coca-Cola and the Swiss company Nestle are joining forces to develop the international market for “ready to drink” tea and coffee, which currently sell in significant amounts only in Japan. Also Procter and Gamble has formed a joint venture with its Italian arch-rival Fater to cover babies’ bottoms in the United Kingdom and Italy.

Some of the available options are:

3.3:1 Licensing: An export manufacturer will enter an agreement with a foreign company authorizing the foreign company to use the production process, trade mark, patent, or trade secret of the exporting manufacturer for a defined fee or royalty. Under this consideration, the exporting manufacturer is the licensor while the foreign partner is the licensee.

The advantage of licensing is that the licensor will gain entry into the market without much difficulty and at a little risk while then licensee will gain production expertise or well-known name without starting from the scratch.

However, the licensor will have less control over the business activities unlike if it had up its own production facilities. Besides, the licensor may even find out that it has set up a competitor. The licensee as well suffers from the foreign interference on it affairs.

3.3:2 Contract Manufacturing: In this strategy, the arrangement will be for the local company in the foreign country to be in charge of the production of the licensed products, while the marketing of the products will rest on the company. The export firm is only exporting its marketing expertise. The advantages and disadvantages of this are similar to that of licensing.

3.3:3 Management Contracting: In some cases, government pressure and restrictions force a foreign company either to sell its domestic operations or to relinquish control. In such a case, the company may have to formulate another way to generate the revenue given up. One way to generate revenue is to sign a management contract with the government or the new owner in order to mange the business for the new owner. The new owner may lack technical and managerial expertise and may need the former owner to manage the investment until local employees are trained to manage the facility. Examples are Aerk Airways, Ondo Oil, etc.

It should be noted that management contracts do not have to be only after a company is forced to sell its ownership interest. Such contracts may be used as a sound strategy for entering a market with minimum investment and minimum political risks. For example, Club Med, a leader I international resort vacations, is frequently wooed by LDCs with attractive financing options because these countries want tourism. Club Med's strategy involves having either minority ownership or none at all, even though the firm manages all then resorts.

3.3:4 Turkey Operations: A turkey operation is an arrangement by the seller to supply with a facility fully equipped and ready to be operated by the buyer's personnel, who will be trained by the seller. The term is sometimes used in fast-food franchising when a franchisor agrees to select a store site, build the store equip it, train the franchisee and employees and sometimes arrange for the financing. In international marketing, the term is usually associated with giant projects that are sold to government or government run companies. Large-scale plants requiring technology and large-scale construction processes unavailable in local markets commonly use this strategy. Such large-scale projects include building steel mills, Fertilizer, and chemical plants; etc.

3.4 Direct Investment: Direct ownership of foreign-based assembly or manufacturing facilities is the ultimate form of foreign investments. The foreign company can buy part or full interest in a local company or build its own facilities. When the firm feels that it has mastered the market and there are opportunities, it will then establish its own production facilities with full management and control.

Some of the advantages include: The company may secure real cost economies in the areas of cheaper labour and raw materials. It can develop manufacturing and marketing policies that will be in agreement with the culture of the people and therefore enhance its long-term international objectives. However, the company suffers from exposing a large investment to certain risks, such as devaluation of currencies, keen competition, etc.

3.5 Free Trade Zones: When entering a market, a company should go beyond an investigation of market entry modes. Another question that should be asked is whether a free Trade Zone (FTZ) is involved and needs consideration. The decisions concerning market entry and FTZs are some what independent. An FTZ can be used regardless of whether the entry strategy is exporting or local manufacturing.

A FTZ is a secured domestic area in international commerce, considered to be legally outside a country's customs territory. It is an area designed by a government for the duty-free entry of goods. It is also a location where imports can be handled with few regulations, and little or no customs duties and excise taxes are collected. As such, goods enter the area without paying any duty. The duty would be paid only when goods enter the customs territory of the country where an FTZ is located, for example Calabar, Nigeria.

Variations among FTZs include free ports, tariff-free zones, airport duty free arcades, export processing zones, and other foreign grade zones. FTZs are usually established in countries for the convenience of foreign trades. The zones may be run by the host government or by private entries.

FTZs offer several important benefits, both for the country and for companies using them. These include:

a) Job retention and creation- when better facilities and plants are provided to attract MNCs, FTZs can generate foreign investment and jobs.
b) Some countries offer superior facilities for lower costs.
c) Lower theft rate, lower insurance costs, delay of tax payment, and reduction of inventory in transit.
d) It improves the cash flow for a company since FTZ eliminates the need to pay duty immediately on docking.
e) An FTZ can eliminate the waiting period for the arrival of a product from an overseas firm.
f) The firm can hold goods in an FTZ until the quota opens up, making it possible to move the goods immediately into the market at the earliest opportunity.
g) FTZs also provide a means to circumvent import restrictions.
h) FTZs provide a means to facilitate imports and exports; some forth.

Self Assessment Exercise

Briefly define FTZ and explain its benefits.

3.6 Introducing a Product into International Market

Introducing a product into international market is not an easy task. The company has to first of all research the market to such an extent that all the components and supportive attributes of the product have to be clearly detected. Both the market research and the product introduction have to be done with careful consideration of the following factors:

3.6:1 Time Scale

In interpreting the research findings, the firm has to take into consideration the dynamic fashion environment in the market and rapidly changing tastes and demands of the consumers. Without that, the firm may discover that it has succeeded in introducing a product that is already out-of-fashion and therefore has no demand in the market. This is one of the tricky aspects of modern international marketing. A tactful marketer must try to combine facts with changing scenes.

3.6:2 Firms Resources and Goals

It is imperative to note that firms have to design their products within the frame-work of their economic realities, resources and goals. Although, the aim is to attain the full satisfaction of the consumers' needs, the firm has to do it in such a way as to make profit or attain other objectives.

3.6:3 Specified Markets

In designing the product, the firm has to have a defined target group at the back of its mind. The target group can be a wide one, consisting of country or region or a small area of few consumers. No matter the size, what is important is that the job must be carried out with a definite buyer in mind.

3.7 Factors to be considered whether to Standardize or to Differentiate

It should be recall that standardization and differentiation have been looked into in the earlier part of the course. Thus, there are many factors to be considered at any time a decision is to be taken on the issue of standardization and differentiation. Some of these are thus briefly examined below:

3.7:1 Corporate Objectives

An international firm that seeks to maximize profits regardless of international market penetration goals is more likely to strike towards product standardization. This is because by the nature of such strategy, the firm is likely to generate a better profit performance in the short-run that if differentiation is opted for.

3.7:2 The Market Usage of the Product

Standardization is hereby recommended where the consumers' usage of the product is similar in all the markets. However, where it differs, differentiation is considered as a better option.

3.7:3 Company Resources

Differentiation involves consideration in production facilities, inventory management and marketing mix ingredients. Because of these financial resources requirements, most weak firms do not go for differentiation strategy, rather prefer standardization strategy option.

3.7:4 Level of Service Required

Products with high technical services either before or after the delivery adopt standardization strategy, for example electronics, automobiles and so forth.

3.7:5 Base of Production

A product that requires intricate manufacturing processes is likely to support differentiation strategy than a product which can be manufactured with ease. Toilet soaps and Aero-plane are two different products with different skills, this thus call for different strategies.

3.7:6 Legal Considerations

Legal systems can have a major impact on the design of a product, its packaging and the printed messages incorporated. For example, a packet of cigarette in Nigeria must contain a warning about the health hazard of smoking. It should however be noted that the law is not interested in the inconveniences that such regulations may impose on marketing personals as it is their duty to assess the market and know which strategy is better option.

Self Assessment Exercise

Briefly examines factors considered whether to standardized or differentiate.

4.0 Conclusion

When a company considers marketing in foreign markets, it needs to analyze such economic characteristics as GNP, income, and population in order to compare market opportunities. Once a particular market is chosen, management needs to decide on the market entry strategy. However, such companies should consider the feasibility of operating all or some of its international business in a free trade zone, since such zone can complement many of the market penetration options.

5.0 Summary

This unit examined various modes of entering international markets.

6.0 Tutor Marked Assignment

What is an FTZ? What are its benefits?

7.0 References/Further Reading:

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Answers to Self Assessment Exercises

1 A FTZ is a secured domestic area in international commerce, considered to be legally outside a country's customs territory. It is an area designed by a government for the duty-free entry of goods. It is also a location where imports can be handled with few regulations, and little or no customs duties and excise taxes are collected. Some of the benefits of FTZ are:

a) Job retention and creation- when better facilities and plants are provided to attract MNCs, FTZs can generate foreign investment and jobs.
b) Some countries offer superior facilities for lower costs.
c) Lower theft rate, lower insurance costs, delay of tax payment, and reduction of inventory in transit.
d) It improves the cash flow for a company since FTZ eliminates the need to pay duty immediately on docking.
e) An FTZ can eliminate the waiting period for the arrival of a product from an overseas firm.
f) The firm can hold goods in an FTZ until the quota opens up, making it possible to move the goods immediately into the market at the earliest opportunity.

g) FTZs also provide a means to circumvent import restrictions.

h) FTZs provide a means to facilitate imports and exports; some forth.

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2 Factors to be considered whether to standardize or differentiate the products are:

1 Corporate Objective**s**

An international firm that seeks to maximize profits regardless of international market penetration goals is more likely to strike towards product standardization. This is because by the nature of such strategy, the firm is likely to generate a better profit performance in the short-run that if differentiation is opted for.

2 The Market Usage of the Product

Standardization is hereby recommended where the consumers' usage of the product is similar in all the markets. However, where it differs, differentiation is considered as a better option.

3 Company Resources

Differentiation involves consideration in production facilities, inventory management and marketing mix ingredients. Because of these financial resources requirements, most weak firms do not go for differentiation strategy, rather prefer standardization strategy option.

4 Level of Service Required

Products with high technical services either before or after the delivery adopt standardization strategy, for example electronics, automobiles and so forth.

5 Base of Production

A product that requires intricate manufacturing processes is likely to support differentiation strategy than a product which can be manufactured with ease. Toilet soaps and Aero-plane are two different products with different skills, this thus call for different strategies.

6 Legal Considerations

Legal systems can have a major impact on the design of a product, its packaging and the printed messages incorporated. For example, a packet of cigarette in Nigeria must contain a warning about the health hazard of smoking. It should however be noted that the law is not interested in the inconveniences that such regulations may impose on marketing personals as it is their duty to assess the market and know which strategy is better option.

UNIT 8: International Marketing

Table of content

1.0 Introduction

Marketing is the process of planning and executing the conception, pricing, promotion, and Distribution of ideas, goods and services to create exchange that satisfy individual believes. That is marketing basically is talking about satisfaction on a daily basis. Companies are striving to satisfy their customers, that is why a lot of them follow their customers abroad. The marketing managers on daily basis work on their task on how to satisfy their customers. He must work with his internal and external environment. The internal include the product, price, place and promotion. While his external are technology, culture, and economy etc. once you go international, the foreign countries factors equally affects your decision. As such this unit focuses on strategies of marketing internationally.

2.0 Objectives

At the end of this unit you should be able to:

1. Differentiate between target market selection and marketing management from international scene.
2. Define international marketing.
3. Explain standardization and adaptation and
4. Explain international promotional policies.

7.1 International Marketing

Kotler and Armstrong (1996) defined marketing as the business function that identifies customers needs and wants, determines which target markets the organization can serve best, and designs appropriate products, services and programmes to serve these markets. Stanton (1981) defines marketing as a total system of business activities designed to plan, price, promote, and distribute want-satisfying goods and services to present and potential customers.

Kotler (1984) defined it as a social process by which individuals and groups obtain what they need and want through creating and exchanging products and value with other.

Marketing is a profit making activity which involves the co-ordination of various functions aimed at facilitating the flow of the required goods and services from the place of production to the place of consumption. A break down of this definition shows that marketing involves:

a. Investigation
b. Designing, and
c. Selling

Having known the definition of marketing, it therefore means knowing what international marketing is, is no problem, in essence it talks about customer's satisfaction beyond the shore in which you are operating in. That is, international marketing involves the extension of the analysis of planning and implementation of marketing resources and programmes to foreign markets. Once a firm extends its marketing resources and programmes beyond its national boundary to other countries, that firm will be said to been engaging in international marketing.

American Marketing Association (AMA) defined international marketing as “the multinational process of planning and executing the conception, pricing, promotion and distribution of ideas, goods, and services to create exchange that satisfy individual and organizational objectives. The inclusion of multinational implies that marketing activities are undertaken in several countries and such activities should somehow be coordinated across nations.

It also means that the international marketing process is not a mere repetition of using identical strategies abroad. The four Ps of marketing (product, place, promotion and price) must be integrated and coordinated across countries in order to bring about the most effective marketing mix. In some cases, the mix may have to be adjusted for a particular market for better impact.

Cateora and Graham (1999) defined international marketing as the performance of business activities designed to plan, price, promote, and direct the flow of a company’s goods and services to consumers or users in more than one nation for a profit.

Although, international marketing does not involve principles found in the domestic marketing, it deserves special attention because of the following factors:

a. Its growing importance as an era of marketing opportunity and
b. Its greater level of risk and uncertainty steaming from the marketer’s unfamiliarity with other cultures.

It therefore calls for critical studying and evaluation of economic, political, socio-cultural and legal environments. In this regard, companies that seek its fortunes in the global markets, should carefully planned its marketing activities abroad, this because its risks are enormous. Likewise its rewards are unquantifiable.

Thus, international marketers should critically focus on:

a. International marketing decisions
b. Market selection decision
c. Entry and operation decision
d. Marketing mix decision, and
e. Market organization decision.

Reasons for International Marketing

Most companies would prefer to remain domestic, if their domestic market were large enough. This because, managers would not need to learn another country's language and laws, deal with volatile currencies, face political and legal uncertainties or redesign their products to suit different customers' needs and expectations. Besides, business would be easier and faster at home.

However, Kotler (1997) gave several reasons that might draw a company into international marketing. Some of these are:

1. Global firms offering better products or lower prices might attack the company's domestic market. The company might want to counter attack these competitors in their home markets to tie up their resources.
2. The company might discover that some foreign markets present higher profit opportunities than the domestic market
3. The company might need a large customer base to achieve economies of scale.
4. The company might want to reduce its dependence on any one market so as to reduce the risk
5. The company's customers might be going abroad and might require international servicing
6. Differences in factor endowment- international trade owe it origin to the varying resources of different regions. Resources are not evenly distributed around the globe, thus some countries are better in some resources than the other.

3.3 Challenges in international Marketing

Most companies, if not all, they are compelled to go abroad, however, wish to limit their marketing activities to home markets. Some of the reasons why some of these companies do not want to abroad include:

1. Unstable Government- High indebtedness, high inflation, and high unemployment (most especially African countries, Nigeria in particular) in several countries have resulted in high unstable governments that expose foreign firms to high risks. Some companies' have to adopt strategy of sponsoring the government in power during campaign processes, because of their investments in such countries. These activities

engaged by these companies, add to the marketing costs which they have to content with. For such reasons, most of the companies do not want to global.

2. High Foreign Indebtedness- Many companies and countries have accumulated huge foreign debts on which it is difficult to pay back, even the interest. This indebtedness could be attributed to loans taken, poor leadership, paying employees abroad, paying necessary taxes, etc, as stipulated by the governments abroad.

3. Foreign Exchange Problem-High indebtedness and economic-political instability decreases the value of a country's currency. Foreign firms want payments in hard currencies with profit repatriation rights. But these options may not be available in total in markets.

4. Foreign Government Entry Requirements and Bureaucracy- Governments of most countries places some regulations on foreign firms operations. These laws and regulations most companies most especially in developing world find it difficult to meet up. Thus, they find it difficult to go abroad.

5. Tariffs and other Trade Barriers- Governments often impose high tariffs to protect their domestic markets. They also resort to invisible trade barriers, such as slowing down import and approvals, requiring costly product adjustments and slowing down inspections or clearance of arriving goods mostly especially at the ports.

6. Corruption- Officials, who charged with the responsibility of discharging one service or the other, requires bribes before necessary documents are signed. Most often they awards contract/business to highest bidders rather lowest bidders.

7. Technological Pirating- A company locating its plant abroad worries about foreign managers learning how tom make its products and breaking away to compete openly either due to some disagreements, change in foreign government and policies, or inability of the firms to meet up with the economic conditions or intentional break-off. All these challenged most companies to go global.

8. High Cost of Production and Communication Adaptation- A company going abroad must study each foreign market critically and carefully, this because it must be sensitive to its economics, laws, politics, and socio-cultural ; and adapt appropriately its products and communications to such markets.

9. Shifting Border issues- Many international boundaries are in a state of flux. National borders are fundamentals to marketing activities, this because they dominate and shape economic behaviour within the country's borders. Changing boundaries may mean moving targets for international marketers.

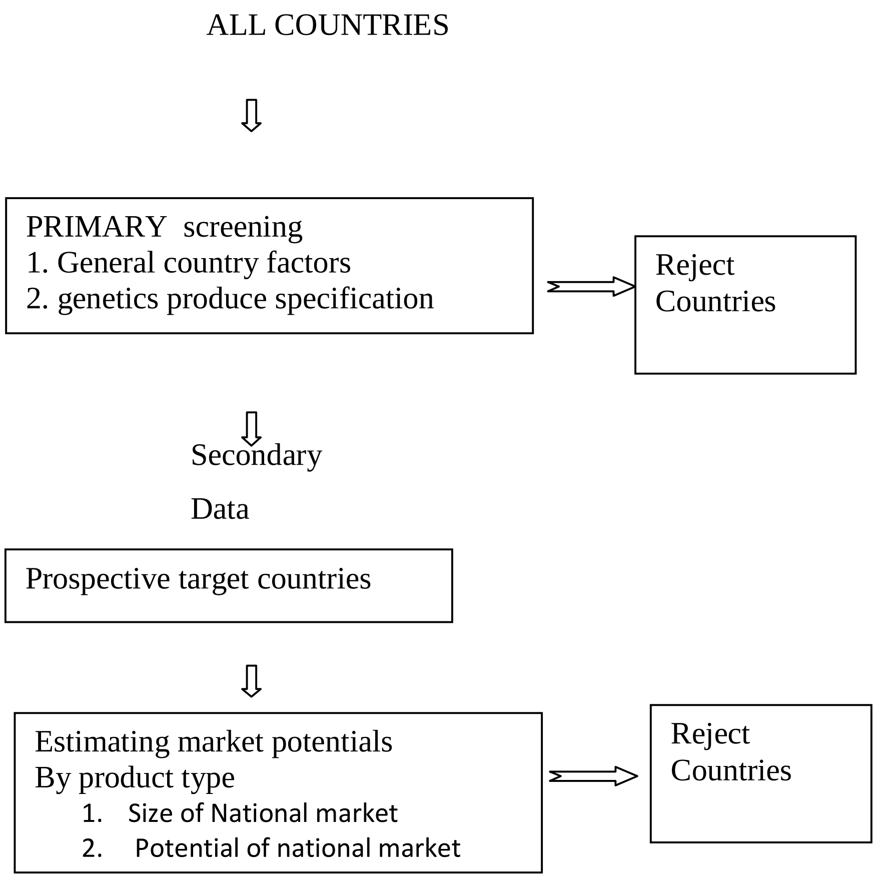
3.3 Target Market Selection

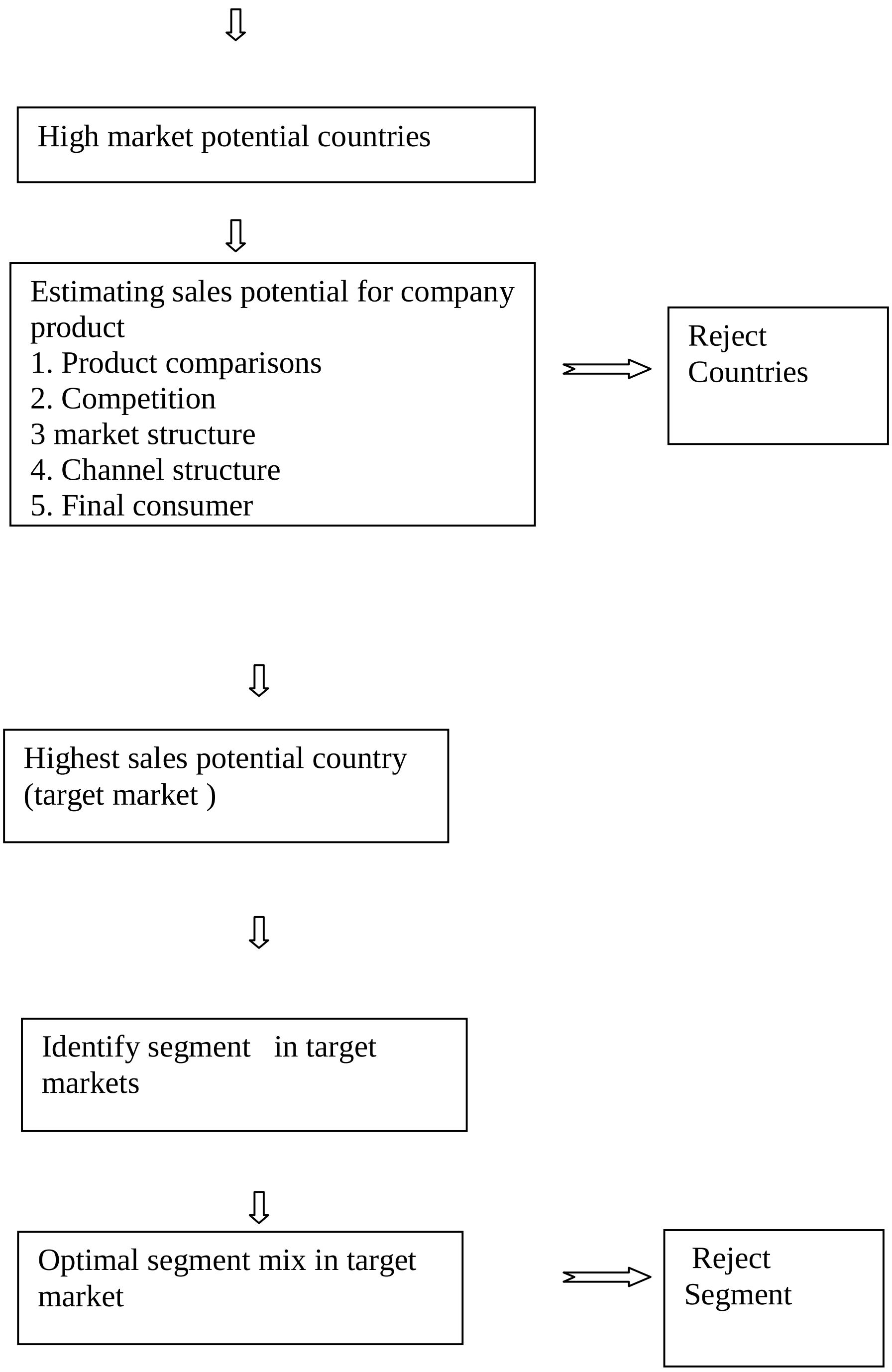
Target market is that segment of the market that a company focuses its attention on so that the consumers will be satisfied. In international business when we discuss about target market selection we are looking at countries for possible target market within which the companies are willing to satisfy. It thus involves:

a. To identify potential markets for entry
b. Expanding selectively over time to those deemed attractive

3.3.1 International Screening

Identification and screening has four stages or process. It starts with very general criteria and ends with product specific market analyses. Data's for screening are gotten from secondary and primary data. The diagram below illustrate this.




High market potential countries
Estimating sales potential for company product
1. Product comparisons
2. Competition
3 market structure
4. Channel structure
5. Final consumer
Reject Countries
Highest sales potential country (target market)
Identify segment in target markets
Optimal segment mix in target market
Reject Segment

Adopted from Michael R (with) iikka A remind Michael H moffe, inland business (USA) smit westen thumpossom leaving each page 33c

The four processes of screening countries that will serve as target market include.

1. Preliminary Screening

It relies solely on secondary data to know the general country factors either favorable or unfavorable to you and the generic product factor. If both are positive on your side it means you have gotten prospective target countries and if unfavorable you reject the countries and look for a more favorable country.

2. Estimating Market Potential

Market potential is the sales in physical or monetary units that might be available to all firms in an industry during a given period under a given level of industry, marketing effort and given environmental condition.

The feeling of whether it is favorable or unfavorable after using the income, elasticity of demand, market audit, analogy and longitudinal analysis to measure the market you either reject the market and if favorable you proceed to what is call high market potential countries.

3. Estimate Sales Potential

After studying the market and believing that they market has prospect, there is need for estimating the sales potential of the target market. You need data to help you look at competition, market, consumer, product and channel structure. If they are favorable you then you can proceed to the next stage, that is the highest sales potential control and if not you can either reject the country or look at other target markets.

4. Identifying Segment

There is need to identify the most profitable target relying mostly on primary data, if it is favorable you proceed to optimal segment mix in target market and if not favorable, you may reject segment and look for a more favorable one.

Self Assessment Exercise

Discuss the steps taken in choosing an international target market

3.3.2 Concentration versus Diversification

.Diversification

Czinkota (2002) reported that concentration is a small number of market or diversification which is characterized by growth in a relatively large number of markets in the early stages of international market expansion. Expansion alternatives- have two options. Concentrate in a small area i.e. a segment or you go into a broad market if the resources are available.

Expansion alternative depend on the following factors.

a. Market growth rate
b. Sales stability
c. Sales response function
d. Competition lead time
e. Spillover effects
f. Need for product adaption
g. Need for communication adaption
h. Economics of scale in distribution
i. Extents of constraints
j. Program control requirement

3.3.3 Marketing Management

Czinkota etal 2002 believes that after target markets are selected, the next step is the determination of marketing efforts at appropriate levels. A key question in international marketing concerned itself with the extent to which the elements of the marketing mix-product, price, place and distribution should be standardized. The market also faces the specific challenge of adjusting each of the mix elements in the international market place.

3.2.4 Standardization versus Adaptation

Here are some factors to be considered under standardization or adaptation.

1. Make no special provision for international market place but rather identify potential target markets and then choose products that can easily be marketed with little or no modification.

2. Adapt to local condition in each and every target market (multi domestic approach).
3. Incorporate differences into a regional or global strategy that will allow for local difference in implementation (globalization approach).

Factors Affecting Adaption

1. The market(s) targeted
2. The product and its characteristics
3. Company characteristics including factors such as resources and policy.

3.3.5 Product Policy

There are lots of factors that affect product adaptation in an international market; they are broadly divided into three.

1. Regional ,Country or Local Characteristics

They may include government regulations non-tariff Barriers, customer's characteristics (Expectations and preferences) purchase patterns economic status of potential users, stages of economic development, competitive offerings, climate and geography.

2. Product Characteristics: They include, product consistent Brands, packaging, physical form of appearance (e.g. Size, Style, Colour) Function, Attributes, Features, method of operation or usage, durability, Quality, Ease of installation, maintenance, after sales services, country of origin.

Product Line Management

International market product line must be local, regional and global brand.

Product Counterfeiting

Is a general problem worldwide, producing inferior product to look like original one. The four way of fighting it, is through legislative action, bilateral and multinational negotiations, joint private sector action and measure fallen by individual forms.

3. Company Consideration

These factors include profitability, market opportunities, (e.g. market potential, product-make fit) cost of Adapting, policies, (e.g. commonality, consistency) organization resources.

Self Assessment Exercise

State two factors that affects product adaptation

3.2.6 Pricing Policy

Price is a critical element in international business. Here are four categories of international pricing situation.

a. Export pricing –

Are dual pricing that differentiate product that are domestic and international. In dual pricing, cost plus and marginal cost method are mostly used; while market differentiated pricing is used base on demand oriented strategy. If not carefully use, it can lead to price escalation or dumping.

b. Foreign Market Pricing

International product pricing for instance when the manufacturer operation is defined by corporate objectives, costs, customer behavior and market conditions market structure and environmental constraints.

c. Price Coordination

Call for price coordination of product in this has increase because of the introduction of Euro. Environmental factor will continue to affect price coordination worldwide, its difficult to coordinate prices worldwide.

d. Transfer Pricing

Transfer or intercompany pricing is the pricing of sales to members of corporate family. It means charging almost the same price for all products in the same industry.

3.3.7 Distribution Strategy

This is what connects the manufactures with the buyers; it takes time for a decision to be arrived at. Distribution strategy takes into account the following.

- Channel design- The length and width of the channel employed is affected by so many factors such as product, market, etc.

- Selection and Screening of Intermediaries- You have to look for appropriate channel members.
- Managing the Channel Relationship- Conflict arises among members because it is like a marriage; you continue to manage these members so as to reduce conflict, if such conflict is not settled it could affect the company.

Self Assessment exercise

Name two institutions that aid distribution in an international business.

3.3.8 Promotion Policy

An international business man must think of the most appropriate promotional mix for his product. Basically, these include: Advertising, personal selling, sales promotion and public Relations. These are briefly explained below.

- Advertising- Majorly, advertising decision focus its attention on which strategy to use. the promotional messages and the organization of the promotional program that must conform with the market been served
- Personal Selling- Is “one on one” selling in international business. Industrial goods, high priced items, require more of personal selling.
- Sales Promotion- Any method of attracting customer for more purchases apart from advertising, personal selling or publicity is sales promotion. They include, coupons, sampling, premiums, point of purchase, direct mail is a good example of sales promotion. Any of these could be used for international marketing depending on the product and the environment.
- Public Relations. Czinkota etal (2002) observed that Public Relation (PR) is the marketing communication function, charged with executing programs to earn public understanding and acceptance. Foreign companies need it for more understanding, for instance the oil companies in Niger Delta and Niger Delta crises is a good example that PR could have assisted if well utilized.

4.0 Conclusion

International business cannot succeed except marketing activities are highly involved. The marketing activities involve selecting the target market and marketing management.

Marketing management involvement monitoring and applying the marketing mix appropriately to satisfy consumers.

5.0 Summary

In this unit you studied how marketing and it activities aids international business. Standardization, adaption and diversification were examined as a way of launching products into an international market. The difference between market concentration and market diversification was also looked into.

6.0 Tutor Marked Assignment

State main factors to be consider while screening oversea markets

7.0 References/Further Reading

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Answers to Self Assessment Exercises

Two factors that need to be considered for product adaptation are:

1. Product Characteristics: They include, product consistent Brands, packaging, physical form of appearance (e.g. Size, Style, Colour) Function, Attributes, Features, method of operation or usage, durability, Quality, Ease of installation, maintenance, after sales services, country of origin.

2. Company Consideration

These factors include profitability, market opportunities, (e.g. market potential, product-make fit) cost of Adapting, policies, (e.g. commonality, consistency) organization resources.

Two institutions that aid distributions for an international business are:

a. Federal ministry of finance and commerce
b. Central banks

UNIT 9: Distribution Strategy

Table of Contents

1.0 Introduction

A manufacturer can sell directly to end users abroad, but this type of channel is generally not suitable or desirable for most consumer goods. In foreign markets it is far more common for a product to go through several parties before reaching the final consumer. The purpose of this unit is to discuss the various channels of distribution that are responsible for moving products from manufacturers to consumers. The unit also describes the varieties of intermediaries involved in moving products between countries as well as within countries. It should be noted that certain types of intermediaries do not exist in some countries and that the pattern of use as well as the importance of each type of intermediary varies widely from country to country. A manufacturer is expected to make several decisions that will affect its channel strategy, including the length, width, and number of distribution channels to be used.

2.0 Objectives

After thorough studying of this unit, you should be able to:

1. Define a channel of distribution for goods or services
2. Explain channel members involved in moving goods from manufacturers to the consumers, and
3. Explain the determinants of channel types

3.0 Main Text

3.1 Channel of Distribution

A channel of distribution for a product is the route taken by the title to the product as it moves from the producer to the ultimate consumer or industrial user. It can also be describe as a set of institutions which performs all the activities or functions utilized to move a product and its title from production to consumption. A channel always includes both the producer and the final customer for the product, as well as all middlemen involved in the title transfer. Even though, agent middlemen do not take actual title to the goods, they are included as part of the distribution channel. This because,
they play such an active role in the transfer of ownership. A trade channel does not include facilitating agencies in marketing. This is because they only assist in the performance of distribution but neither takes title to goods nor
negotiates purchases or sales.

3.2 Forms of Channel of Distribution

Companies use two principal channels of distribution when marketing abroad. These are indirect selling and direct selling.

Indirect selling, also known as the local or domestic channel, is employed when a manufacturer in Nigeria, for example, markets its product through another Nigeria's firm that acts as the manufacturer's sales intermediary. By exporting through an independent local middleman, the manufacturer has no need to set up an international department. The middlemen's, acting as the manufacturer's external export organization, usually assumes the responsibility for moving the product overseas. The intermediary may be a domestic agent if it does not take title to the goods, or it may be a domestic merchant if it does take title to the goods.

Some of the advantages to be gained by employing an indirect domestic channel include:

1. The channel is simple and inexpensive- the manufacturer incurs no start-up cost for the channel and is relieved of the responsibility of physically moving the goods overseas.
2. The intermediary very likely represents several clients who can help share distribution costs, the costs for moving the goods are further reduced.

An indirect channel does have some limitations, which include:

1. The manufacturer has been relieved of any immediate marketing costs, but in effect, has given up control over the marketing of its products to another firm. This situation may adversely affect the product's success in the future.
2. The indirect channel may not necessarily be permanent. Being in the business of handling products for profit, the intermediary can easily discontinue handling a manufacturer's product if there is no profit or if a competitive product offers a better profit potential.

Direct selling is employed when a manufacturer develops an overseas channel. This channel requires that the manufacturer deal directly with a foreign party without going through an intermediary in the home country. The manufacturer must set up the overseas channel to take care of the business activities between the countries. Being responsible for shipping the product to foreign markets itself, the manufacturer exports through its own internal export department or organization.

Some of its advantages are:

1. There is active market exploitation
2. There is a greater control

However, it suffers from difficulty in management of the channel, especially if the manufacturer is unfamiliar with the foreign market. Also, the channel is time consuming and expensive.

3.3 Types of Intermediaries: Direct Channel

There are several types of intermediaries associated with direct channel of distribution. Some of these include:

a) Foreign Distributor

A foreign distributor is a foreign firm that has exclusive rights to carry out distribution for a manufacturer in a foreign country or specific area. Orders must be channeled through the distributor, even when the distributor chooses to appoint a subagent or sub distributor. The distributor purchases merchandise from the manufacturer at a discount and then resells or redistributes the merchandise to retailers and sometimes final consumers. Hence, the distributor's function in many countries may be a combination of wholesaler and retailer. But in most cases, the distributor is usually considered as an importer or foreign wholesaler. In some situations, the foreign distributor is merely a subsidiary of the manufacturer.

b) Foreign Retailer

Foreign retailers are employed for consumers' products rather industrial products.

c) State-Controlled Trading Company

Some products are sold to state-controlled trading company, before they are further resell to individuals and institutions. These entail heavy equipment and machineries.

d) End user

Sometimes, a manufacturer is able to sell directly to foreign end user with no intermediary involved in the process. The direct channel is a logical and natural choice for costly industrial products. However, it is challenging, for example, a consumer may place an order without understanding his or her country's import regulations. When the merchandize arrives, the consumer may not be able to claim it. As a result, the product may be seized or returned on a freight-collect basis. Continued occurrence of this problem could become expensive for the manufacturer.

Indirect Channel

For a majority of products, a manufacturer may find it impractical to sell directly to the various foreign parities. Other intermediaries more often than not, have to come between these foreign buyers and manufacturer's country. With an indirect channel, a manufacturer does not have to correspond with foreign parties in foreign countries. Agents can be further classified according to the principal whom they represent.

a) Export Broker

The function of an export broker is to bring a buyer and a seller together for a fee. The broker may be assigned some or all foreign markets in seeking potential buyers. It negotiates the best terms for the seller, but cannot conclude the transaction without the principal's approval of the agreement. As a representative of the manufacturer, the export broker may operate under its own name or that of the manufacturer.

b) Manufacturer's Export Agent or Sale Representative

This is an independent business person who usually retains his or her own identity by not using the manufacturer's name. A sales representative can select when, where and how to work within the assigned territory. Working methods include presenting product literature and samples to potential buyers. The manufacturer's export agent works for commission. The manufacturer's export agent may present some problems to the manufacturer because an agent does not offer all services. An export agent may take possession but not title to the goods and thus assumes no risk- the risk of loss remains with the manufacturer.

c) Export Management Company (EMC)

An export management company (EMC) manages, under contract, the entire export program of a manufacturer. An EMC is also known as a combination export manager (CEM) because it may function as an export department for several allied but non-competing manufacturers. The EMC has greater freedom and consideration authority. The EMC provides extensive services, ranging from promotion to shipping arrangement and documentation. The EMC is responsible for all of the manufacturer's international activities.

d) Cooperative Exporter

A cooperative exporter is a manufacturer with its own export organization that is retained by other manufacturers to sell in some or all foreign markets. Except for the fact that this intermediary is also a manufacturer, the cooperative exporter functions like any other export agents. It operates as an export distributor for other suppliers. Tit takes possession of goods but not title.

e) Others forms of agents include:

1. Purchasing/Buying Agent
2. Country-Controlled Buying agent
3. Resident buyer
4. Export merchant
5. Export drop shipper

6. Export distributor
7. Trading company; etc.

This can be summarized using the following figure 3.1

Figure 3.1 Types of Marketing Channels

1. Manufacturer____________________________________ Consumer or
Industrial user

1. Manufacturer________________ Retailer in___________ Consumer or
Foreign country industrial user.

3. Manufacturer_______ Wholesaler_____retailer_______ Consumer or
in foreign in foreign industrial user
Country country

4. Manufacturer_ Importing___Do_________ Do______________Do_____
Middlemen
In foreign
Country.

5. Manufacturer__ exporting___ Do________ Do_______________ Do___
Middlemen

6. Manufacturer__ exporting__ Importing__ wholesaler___ retailer_ con. or
Middlemen middlemen in foreign in foreign indust.
Foreign country country user.
country

3.4 Channel Adaptation

Because the standardization/globalized approach to international marketing strategy may not apply to distribution strategy in foreign markets, it is imperative that international marketers understand the distribution structures and patterns in those markets/countries. Hence, comparative analysis should be conducted.

Some channel adaptation is frequently a necessity. For example, Avon has had to develop other distribution methods in Japan and Thailand. A traditional distribution channel may seem inefficient, inefficient, but it may maximize the utilization of inexpensive labour, leaving no idle resources.

A manufacturer must keep in mind that, because of adaptation, a particular type of retailer may not operate in exactly the same manner in all countries. A particular distribution concept proven useful in one country may have to be further refined in another.

3.5 Determinants of Channel Types

There is no single across-the-board solution for all manufacturers' channel decisions. However, there are certain guidelines that can assist a manufacturer in making a good decision. Factors that must be taking into consideration include:

1. Objectives of the firm

The objectives of the firm are the corner-stone that determines the kind of channel to be used in any given market. This is because it is the objective that will determine whether the channel to be selected should be long or short.

2. Legal Considerations

A country may have specific laws that rule out the use of particular channels or middlemen. France, for example, prohibits the use of door-to-door selling. Although private importers in Iraq may choose to deal through commission agents, Iraqi legislation prohibits state enterprises from dealing with third-party intermediaries in obtaining foreign supplies. Also, Saudi Arabia requires every foreign company which work there to have a local sponsor who receives about 5 percent of any contract

The overseas distribution channel often has to be longer than desired. This is because of government regulations, a foreign company may find it necessary to go through a local agent/distributor. Channel width may be affected by the laws as well.

3. Managerial Resources

The management of distribution channels depends on to a great extent on the experiences that vest in the firm's mangers. A firm that is entering an international market for the first time, mighty lacks the expertise that is required to be able to choose and control short channels or the firm's own local subsidiary. Such firms would prefer to give the job to middlemen. Sometime, even well-established firms often seek the assistance of middlemen in cases of involving new products or new \segments that calls for the acquisition of a new type of experience.

3. Product Image

The product mage desired by a manufacturer can dictate the manner in which the product is distributed. A product with a low-price image requires intensive distribution. On the other hand, it is not necessary or even desirable for a prestigious product to have wide distribution. For example, Waterford Glass has always carefully nurtured its posh image by limiting its distribution to top-flight department and specialty stores. Although intensive distribution may increase sale in the short run, it is potential harmful to the product's image in the long run.

4. Channel Availability

This is of course a major consideration as one will not expect to selects a specific type of channel in a given country if:

a. Such a channel does not exist
b. It belongs to a competitor
c. It does not wish to distribute your product.

5. Product Characteristics

The type of product determines how that product should be distributed. For low priced, high-turnover convenience products, the requirement are for an intensive distribution network. The intensive distribution of ice cream is an example.

For high-unit-value, low-turnover specialty goods, a manufacturer can shorten and narrow its distribution channel. Consumers are likely to do some comparison shopping and will more or less actively seek information about all brands under consideration. In such cases, limited product exposure is not an impediment to market success

One should always remember that products are dynamic, and the specialty goods of today may be nothing moiré than the shopping or even convenience goods of tomorrow. For example,. Computers which were once an expensive specialty product that required a direct and exclusive channel, today they have become shopping goods, necessitating a long and more intensive channel.

6. Middlemen's Loyalty and Conflict

One ingredient for an effective channel is satisfied channel members. As the channel widens and as the number of channels increases, more direct competition among channels members is evitable.

7. Local Customs

Local business practices, whether outmoded or not, can interfere with efficiency and productivity and may force a manufacturer to employ a channel of distribution that is longer and wider than desired. For example, Because of Japan's mutlitiered distribution system, which relies on numerous layers of middlemen, companies often find it necessary to form a joint venture with Japanese firms.

Domestic customs can explain why a particular channel is in existence. Yet customs may change or may b overcome\me, especially if consumer tastes change. For example Onkvisit and Shaw (1997: 486) reported that there are some 82, 000 British pubs, 50,000 of which are owned by brewing companies; the problem they face was the trend toward beer consumption at home. The pubs have had to adjust by emulating trendy American bars, selling more win and such food as hamburgers.

8. Control

If it has a choice, a manufacturer that wants to have better control over its product distribution may want to both shorten and narrow its distribution channel. However, control to be administered depends on the nature of the products and laws of such countries, the products being marketed to.

In conclusion, there other factors that affect channel decisions. However, most of these factors are inter-related.

Self Assessment Exercise

State determinants of channel types

3.6 Channel Management Decision

Whether then intermediaries are the employees of the firm's subsidiary or whether they are totally independent, there is a mutuality of interest between the supplying company and its channels' personnel and it is important that the best principles of management employed. After a company has determined its basic channel deign, individual middlemen have to be managed in such a way as to:

1. Create distributor loyalty
2. Ensure that distributors are adequately remunerated
3. Train and develop distributors
4. Determine standards of performance, and
5. Evaluate performance against standard.

Self Assessment Exercise

Motivation of channel members is necessary for what reasons?

4.0 Conclusion

A product, no matter how desirable, must be accessible to buyers. A manufacturer my attempt to use a direct distribution channel by selling directly to end users abroad. The feasibility of this channel depends on the type of product involved. Generally, the sales opportunity created by direct selling is quite limited. Intermediaries are usually needed to move the product efficiently from the manufacturer to the foreign users.

5.0 Summary

This unit examined various channel members involved in moving goods/services to the end users. These channels are classified into six. The channel chosen by marketing executives depends of the nature of the products and the expertise of the channel members. It also considered factors to be look into before selecting a channel.

6.0 Tutor Marked Assignment

What are the factors that affect the length, width and number of marketing channels?

7.0 References/Further Reading

Bert, R and Trina, l. L: "International Channels of Distribution and the Role of Comparative Marketing Analysis," Journal of Global Marketing 4 (no.4, 1991): 39-42.

Eze, B. I: International Marketing, Bauchi, ATBU, 1999. (Unpublished Lecture note).

Ketler, P: Marketing Management-Analysis, Planning, Implementation and Control, 9th Edition, New Jersey, Prentice-Hall, 1997.

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Answers Self Assessment Exercises

1) Determinants of channel types include:

a. Objectives of the firm

b. Legal Considerations

c. Managerial Resources.

d. Product Image

e. Channel Availability

f. Product Characteristics

g. Middlemen's Loyalty and Conflict and

h. Local Customs

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2. Motivation of channel members is necessary for such reasons as to:

1. Create distributor loyalty
2. Ensure that distributors are adequately remunerated
3. Train and develop distributors
4. Determine standards of performance, and
5. Evaluate performance against standard.

UNIT TEN 10: Export and Import Practice

Table of Content

1.0 Introduction

Exporting and import is an important aspect of modern business.

Exporting is one of the ways of taking your goods abroad while importing is a way foreign businessmen send their goods to your own country. This unit discusses reasons for exporting and importing. It also examines situation what export and import entails. It also explains process and documents involve in export and import of goods

2.0 Objectives

On successful completion of this unit, you should be able to:

1. Define export and import.
2. Describe people who are involved in export
3. Give reasons for export
4. Mention procedure for import and export

5. List documents involved in exporting and importing of goods/ and services

3.0 Main Text

3.1 Export and Import

Export –is a method of selling your goods abroad

Import-is purchasing of goods from outside countries to your home country for example, buying Gold from Ghana.

Who exports?

There was that believe that small companies are mostly involve in exporting because they do not have the money to establish companies abroad. In today's research, both small and large companies are involved in exporting. In essence a lot of companies are involved in exporting provided you are legally permitted to do so.

3.2 Why Exports

Companies export for the following reasons

- To increase profit and sales
- Protect their business from being eroded

By exporting, companies are likely to achieve these:

- To serve markets where the firm has no production facilities or the local plant does not produce the firm complete product mix
- To satisfy a host of government requirement.
- To test foreign market and foreign competition inexpensively.
- To remain competitive in the home market
- To meet actual or prospective customer request for the firm to export
- To off set cyclical sales of the domestic market.
- To achieve additional sales, which allow the firm to use its excess production capacity to cover unit fixed costs
- To extend a products life cycle by exporting to counties where technology is less advanced
- To distract foreign competitions that is in the firm home market by entering their home markets and
- To improve equipment utilization rates.

3.3 Reasons why firms don't Export

Some companies do not wish to export. Some of the reasons why they do not export include:

1. Preoccupation with the home market
2. Reluctance to be involve in a new and unknown operation.

Some known exporting firms in US gives the following reasons for not engaging in international business

a. Payment and financing markets- The payments and finance involves in foreign market is considered to be huge, and not easily recouped
b. Locating foreign markets- Locating foreign markets involves a lot of research which is capital intensive.
c. Export procedures- Export procedure vary from country to country and this need to be critically studied before embarking on foreign market business

3.4 Sources of Export Counselling

Information about foreign market which an international businessman wishes to go into can be obtained through:

a. Trade information center
b. Department of Agriculture
c. Small business Administration

In Nigeria, they're so many agencies where you can get your export counseling from, some of these include:

i. Central bank
ii. Ministry of foreign affairs
iii. Nigeria investment promotion council
iv. Nigerian export processing zone Authority
v. Customs and excise and a host of others.

Self Assessment Exercise

State four sources of export counselling

3.4.1 Export Payment Terms

In US, there are basically five kinds of payment terms, offered by exporters to foreign buyers, these are:

i.Cash Advance

When a buyer is not well known in terms of his credit standing he is given cash in advance. Its disadvantages are that it will tie down the buyer's capital because he needs to receive the goods and sell first before payment. Sometimes, what is ordered for may not be received. Therefore buyers prefer paying cash to collect their goods immediately.

ii. Open Account

An open account sales is offered to a reliable customer where an economy is stable, the seller takes the whole risk. The exporters' capital is tied down until payment has been received, sometimes you can use letter of credit as an alternative.

iii. Consignment

Goods ship to the buyer, and payment is not made until goods are sold. The seller takes all the risk. Multinationals are involved in this type of sales, for example lever brother Nig. Ltd, UAC etc.

iv. Letters of Credit

Documents issued by the buyer bank in which the bank promises to pay the seller a specified amount under specified conditions. Letters of credit could be confirmed and irrevocable

Confirmed- Is an act of correspondent bank in the seller's country by which it agrees to honour the issuing bank letters of credit

Irrevocable- Is a stipulation that a letter of credit can not be cancelled.

Air way bill- is issued by the carrier which is presented as proof that shipment has been made.

Before you open a letter of credit, you as buyer should frequently request for a pro-forma invoice, which is seen, as exporter's formal quotation containing a description of the merchandise, price, delivery time, method of shipping, term of sale, and points of exit and entry

Letter of credit transactions- it means the route taken by the merchandise, letter of credit and documents in a letter of credit transaction.

v. Documentary Drafts

Ball etal (2002) opined that when the exporter believes that political and commercial risks are not sufficient to require a letter of credit the exporter may agree to use a documentary draft basis, which is less costly to the buyer.

Export Draft- Is an unconditional order that is drawn by the seller on the buyer to pay the drafts amount on presentation (sight draft) or at an agreed future date (sight draft) and that must be paid before the buyer receives shipping document

3.5 Payment and Financial Procedures

Different countries have different payment and financing procedure, this involves the documents used in export procedures. This procedure is follows strictly before any businessman is allowed to export to any country.

1. Foreign Freight Forwarders

These are special independent business that handles export shipments for compensation. They are experts in this field they offered advises in terms of markets, import and export regulations, and the best mode of transport, export packing and cargo insurance.

2. Export Financing

Export financing are both private and public. The private sources include:

3. Bankers Acceptance- A time draft with maturity of less than 270 days that has been accepted by the bank in which the draft was drawn, thus becoming the accepting banks obligation. May be document may be bought and sold at a discount in the financial market like other commercial paper.

Factoring- Discounting without recourse to an account receivable

Forfeiting –Purchasing without recourse to account receivable, whose credit terms are longer than the 90 to 180 days usual in factoring; unlike factoring, political and transfer risk are borne by the Forfeiter.

Export- Import Bank- It is a bank own by federal government that aids its citizen who are ready for exports by means of loans, guarantees by insurance programmes- They grant:

. Direct and intermediary loans

. Working capital guarantees

. Guarantees

. Export credit insurance

Public Source

In America the have:

i. Overseas private investment corporation

ii. Foreign sales corporation

iii. Foreign trade zone

Self Assessment Exercise

State why firms do not exports

3.6 Export Procedures

It means the documentation before exporting. Countries to countries have different system. Nigerian government has a complex exporting system; of recent the federal government is trying to correct the system, it targets is 48 hours for clearing goods.

1. Export Documents

Export document are divided into two-

i. Shipping document
ii. Collection document

Shipping Document- they include

Shippers Export Declaration (SED) - This document is required by the Department of commerce to control export and supply export statistics, it contains the following.

. Name and address of the shipper and consignee.

. US port of exit and foreign point of unloading.

. Description and Value of the goods

. Export license number and bill of lading number.

. Carrier transporting the merchandise

ii. Export License- As any export license covering export commodities for which a validated license is not required, no formal application is required. Strategic materials and all shipments to unfriendly country validated export license are required.

iii. Export Bill of Lading- It serves as a contract for carriage between the shippers and the carrier, a receipt from the carrier for the goods shipped and a certificate of owner ship.

iv. Insurance Certificate- It is evidence that the shipment is insured against loss or damage while on transit.

v. Automatic Export System (AES) - Is a one-stop export filling system- a single information collection and processing center for the electronic filling of the export shipments documentation required by the US government.

Collection Documents- They include

i. Commercial Invoices- They are just like domestic invoice with additional information such as origin of goods, export packing marks and a string attached that goods will not be diverted to another country.
ii. Consular Invoice- These are export forms purchase from the consult written in the language of the country.
iii. Certificate of Origin- Some countries like Nigeria requires this to know from which country the goods are coming from.
iv. Inspection Certificate- when goods are exported in containers, lighter abroad ship (Lash) RoRo (Roll on – Roll off) and freight are use to move goods from one country to the US.

3.7 Pitfalls and Mistakes of New Exporter

These include among others:

1. Failures to obtain qualified export counseling and develop a master international marketing plan before starting an exporting business
2. Insufficient commitment by top management to overcome the initial difficulties and financial requirement of exporting.
3. Insufficient care in selecting overseas distributors.
4. Chasing orders from around the world instead of establishing a basis for profitable operations and orderly growth.

5. Neglecting export business when income market booms.
6. Failure to treat international distributors on an equal basis with domestic counter parts.
7. Assuming that a given market technique and product will automatically be successful in all countries.
8. Unwillingness to modify products to meet the regulations or cultural references of other countries.
9. Failure to print service sale and warranty messages in locally understood languages.
10. Failure to consider the use of an export management company.
11. Failure to consider licensing or joint venture agreements
12. Failure to provide readily available servicing for the product

3.8 Importing

Importers are opposite of exporters, they buy abroad and sell in the domestic market. Importer can identify source of importers through:

. Retailers who import similar products

. You can contact all agencies that can assist in importing

. In US you can use the electronic bulleting boards of the world trade center. In Nigeria you can visit websites.

While importing you take note of customhouse brokers, who are independent businesses that handle import shipment for compensation. They act as agent for the importer once they import goods, they put them in bonded warehouses or they can abandon them or send them to another country.

Every importer should take note how this countries customs calculate Import duties and Importance of the product classification.

For any importer he needs to take note of the following

. Disclose to the customs all foreign and financial arrangements before passing the goods. Penalties are always high.

. Ask the advice of a customhouse broker before making the transaction

. Calculate carefully the landed price in advance

4.0 Conclusion

Export is necessary for a country so that balance of trade will be favorable for your country by so doing the economy of your country will improve. You must locate the new market and you need counseling before exporting. You should always study export procedures and export documents in order to achieve maximum results in your business.

5.0 Summary

This unit examined export and import practices as it applies to international business. Emphases were on America practice as a case study.

6.0 Tutor Marked Assignment

State five pitfalls of a new exporter

7.0 References/Further Reading

Ball. A D, et al (2002) International Business: The Challenge of Global Competition, 8th Edition, Irwin, McGraw-Hill

Answers to Self Assessment Exercises

1. Sources of export counseling include:

a. Central bank
b. Ministry of foreign affairs
c. Nigeria investment promotion council
d. Nigerian export processing zone Authority
e. Customs and excise and a host of others

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2. Firms fail to exports due to:

a. Preoccupation with the home market
b. Reluctance to be involve in a new and unknown operation.

Unit 11: Multinational Corporations (MNCs)

Table of Content

1.0 Introduction

Firms going global are inevitable in modern business. This is because there are both challenges and threats which they have to content with. Some products are produced not for the consumption of local markets but for international markets. International market calls for critical studying of consumer's preference, purchasing power and socio-cultural factors. Multinational corporations (MNCs) are major actors in the world business. Modern communication and transportation systems have made international business much easier than before. For instance, globalization and internet facilities have aided the process of multinational corporations. This unit looked into various definitions of multinational corporations, argument against MNCs and forms of multinational corporations.

2.0 Objectives

On successful studying of this unit, you should be able to:

1. Define a multinational corporation
2. List the criticism for and against multinational corporation and
3. Classify forms of multinational corporations

3.0 Main Text

3.1 Multinational Corporation

a. Definition by size

The term MNC implies bigness. But bigness also has a number of dimensions. Such factors like market value, sales, profits and return on equity, when used to identify the largest multinationals will yield varying results. For instance, Onkvisit and Shaw (1997) report that General Motors is number thirty-six in terms of market value; it is number one in terms of sales and number two based on profits declared. This goes to shown the variance in the definition of MNCs by size.

It is not unusual for corporate size in terms of sales to be used as a primary requirement for judging whether or not a company is multinational. According to the United Nations Department of Economic and Social Affairs, companies with less than $100 million sales can safely be ignored. Based on this definition, about 300,000 small and midsize German companies do not qualify even though these firms contribute mightily to Germany's export success.

Many multinational corporations are indeed large. According to the World Investment Report of the United Nations Conference on Trade and Development (UNCTAD), there are some 40,000 transnational corporations (TNCs) with more than 250, 000 foreign affiliates, altogether generating more than $5 trillion in annual sales.

Is corporate size a good indicator of international orientation? According to conventional thought, firm size should positively influence export intensity. Onkvisit and Shaw (1997) observed that recent study of the Italian manufacturing industry has falsified the proposition concerning the positive relationship between firm size and export intensity. Another study of 4,072 Canadian manufacturers found a positive but only modest relationship between firm size and export propensity. It should be noted that International Business Machine (IBM) did not become multinational because it was large, but rather that it became large s a result of going international. Therefore, corporate size should not be used as the sole criterion for multinational.

b. Definition by Structure

According to Aharoni, an MNC has at least three significant dimensions: Structure, performance and behavior. Structural requirements for definition as an MNC include the number of countries in which the firm does business and the citizenship of corporate owners and top managers. For instance, Singer Corporation sells its Sewing Machines in 1st Centuries, thus satisfying the requirement with regard to the number of countries. In addition, Citicorp satisfies the requirement for multinationals through the citizenship of members of its top management. The company has done as much as other major American MNCs to diversify its management.

Self Assessment Exercise

Describe Multinational Corporation by size

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c. Definition by Performance

Definition by performance depends on such characteristics as earnings, sales, and assets. These performance characteristics indicate the extent of the commitment of corporation resources to foreign operations and the amount of rewards from that commitment. The greater the commitment, then the grater would be the reward, and the grater the degree of internationalization. Parker Pens with 80 per cent of its sales coming from overseas, is more multinational than A.T. Cross, whose overseas sales account for only about 20 per cent of overall sales (United Nations Conference on Trade and Development, 1995).

Human resources or overseas employees are constantly considered as part of performance requirements through the desirability of separating lower lever employees from top management, is questionable. A preferable analysis would be to treat the total extent of the employment of personnel in other countries as another indicator of the structure of the company. In any case, the willingness of a company to use overseas personnel satisfied a significant criterion for multinationals. Avon, for example employ’s 370, 000 Japanese women to sell its products house to house across Japan. Siemens, well known worldwide for its consumer and industrial products has some 300,000 employees in 124 countries. This therefore poses some difficulties in defining multinationals by performance.

d. Definition by Behaviour

This requirement concerns the behavior characteristics of top management. Hence, a company becomes more multinational as its management thinks more internationally. Such thinking is known as "ethnocentricity" which should be distinguished from poly-centricity and egocentricity. Ethnocentricity is a strong orientation toward the home country. Markets and consumers abroad are viewed as unfamiliar and even inferior in taste, sophistication and opportunity. The usual practice is to use the home base for the production of standardized products for exports I order to gain some marginal business. Centralization of decision making is thus a necessity.

Poly-centricity is a strong orientation to the host country. The attitude places emphasis on differences between markets that are caused by variations within, such as income, culture, laws and politics. The assumption is that each market is unique and thus difficult for outsiders to understand. Therefore, managers from the host country should be employed and allowed to have a greater deal of discretion in market decisions. A significant degree of decentralization is so common across the overseas divisions.

Geo-centricity-It has been argued that this attitude is the most important of the three. Geo-centricity is an orientation that considers the whole world rather than any particular country as the target market. A geo-centricity company might be thought of as decentralized or supranational. As such 'international' or 'foreign' departments or markets do not exist because the company does not designate anything international or foreign about a market. Corporate resources are allocated without regard to national frontiers and there is no hesitation in making direct investment when necessary.

There is a high likelihood that a geo-centric company does not identify itself with a particular country. Hence, it is often difficult to determine the firm's home country, except through the location of its headquarters and its corporate registration. Geo-centric firms are of the views that even though countries may differ, differences can be understood and managed. In coordinating and controlling the global marketing effort, the company adapts its marketing program to meet local needs within the broader framework of its total strategy. The approach combines aspects of centralization and decentralization in a synthesis that allow degree of flexibility.

To drive this point’s home, the case of European Silicon Structures illustrates the practice of geocentric marketing. In order to attract customers from around the continent, the company has decided to become a company without a country. Although incorporated in Luxembourg, the firm’s headquarters is in Munich. The company has research facilities in England and a factory in Southern France. With regard to its board of directors, the eight members come from seven countries

In conclusion, being international or multinational is a matter of degree. It should not be based on a single variable, but rather a combination of variables in order to accommodate differences in personnel, sale volume, and other resources.

3.2 Arguments for Multinational Corporations (MNCs)

The existence of multinational corporations creates a further development on the globe. More and more of them have been trying to be responsible members of the society. For example, Onkvisit and Shaw (1991) reported that Toyota Company has been supporting American community projects. Also, multinational corporations have power and prestige; hence they create social benefits by facilitating economic balance.

3.3 Argument against MNCs

The mentioning of MNCs usually elicits mixed reactions. MNCs are considered as firms associated with exploitation and ruthlessness. They are often criticized for moving resources in and out of a country as they strive for profit without much regard for the country’s social welfare. For example, Varity Corp, a Canadian Multinational firm was criticized for its action in 1991 to relocate its headquarters from Toronto to the United States (Buffalo) in order to take advantage of the US Canadian Free Trade Agreement. In addition, Indians referred to MNCs as “agent of neocolonialism”. They considered MNCs such as Pepsi Cola, Coca Cola, and host of others as “foreign devils”.

Self Assessment Exercise

Discuss argument against multinationals (MNCs)

3.3 Patterns of Multinational Corporations

Multinational market group take several forms, varying significantly in the degree of cooperation, dependence and inter-relationship among participating nations. There are five fundamental groupings which are briefly explained below:

1. Regional Corporation Groups

The most basic economic integration and cooperation is the regional cooperation for development. In the regional cooperation for development arrangement, governments agree to participate jointly to develop basic industries beneficial to each economy. Each country makes an advance commitment to participate in the financing of a new joint venture and to purchase a specified share of the output of the venture. Most capital intensive projects in Nigeria are carried out through this form of cooperation between the federal republic of Nigeria and necessary country concerned.

2. Free Trade Areas

A free trade area (FRA) requires more cooperation and integrations than the regional cooperation groups. It is an arrangement among two or more countries to reduce or eliminate custom duties and non-tariff trade barriers among partner countries, while members maintain individual tariff schedule for external countries. That is, an FTA provides its members with a mass market without barriers that impede the flow of goods and services. For example, the United States has free trade agreements with Canada and Mexico and separately with Israel.

3. Customs Union

A customs union represents the next stage in economic cooperation. It enjoys the free-trade area's reduced or eliminated internal tariffs and adds a common external tariff on products imported from countries outside the union. The customs union is logical stage of cooperation in the transition from an FTA to a common market. Examples are European Union and Economic Community of West African States (ECOWAS), and host of others.

4. Common Market

A common market agreement eliminates all tariffs and other restrictions on internal trade, adopts a set of common external tariffs and removes all restriction on the free flow of capital and labour among member nations. It is a unified economy and lacks only political unity to become a political union.

5. Political Union

Political union is the most fully integrated form of regional cooperation. It involves complete political and economic integration, either voluntary or enforced. The most notable (enforced) political unions was the Council for Mutual Economic Assistance, Commonwealths of Learning, Economic Community of West Africa States (ECOWAS)

4.0 Conclusion

Engaging in international business these days is no longer a choice, but compulsion. This is because domestic markets may be inadequate, to curb competitors products and look for new market and opportunities for the firm. To be specific to sell the excess of domestic products and services, international market is one of the best alternatives. However, the more commitment company makes to overseas markets in terms of personnel, sales and resources, the more likely it will become a multinational corporation (MNC). This is especially true when the management is geo-centric rather than ethnocentric or polycentric.

5.0 Summary

This unit examined Multinational Corporation (MNCs) as an arm of international business activities. Various definitions of multinational corporations were discussed; argument for and against were explained, and forms of multinational corporation were looked into.

6.0 Tutor Marked Assignment

Briefly explain arguments multinational corporations

Answer

MNCs are considered as firms associated with exploitation and ruthlessness. They are often criticized for moving resources in and out of a country as they strive for profit without much regard for the country's social welfare. For example, Varity Corp, a Canadian Multinational firm was criticized for its action in 1991 to relocate its headquarters from Toronto to the United States (Buffalo) in order to take advantage of the US Canadian Free Trade Agreement. In addition, Indians referred to MNCs as "agent of neocolonialism". They considered MNCs such as Pepsi Cola, Coca Cola, and host of others as "foreign devils".

7.0 References/Further Reading

Rao, T.R and Naidu, G. M (1992)" Are the stages of Internationalization Empirically Supportable?" Journal of Global Marketing, 6, No 2, PP.148-150

Onkvisit, S and Shaw, J.J (1997) International Marketing-Analysis and Strategy, 3rd Edition, New Jersey, Prentice-Hall, Inc.

Answers to Self Assessment Exercises

1. According to the United Nations Department of Economic and Social Affairs, companies with less than $100 million sales are considered not multinational corporations. Therefore multinational corporations are those companies with above $100 million sales

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2. MNCs are considered as firms associated with exploitation and ruthlessness. They are often criticized for moving resources in and out of a country as they strive for profit without much regard for the country's social welfare. For example, Varity Corp, a Canadian Multinational firm was criticized for its action in 1991 to relocate its headquarters from Toronto to the United States (Buffalo) in order to take advantage of the US Canadian Free Trade Agreement. In addition, Indians referred to MNCs as "agent of neocolonialism". They considered MNCs such as Pepsi Cola, Coca Cola, and host of others as "foreign devils".

UNIT 12: Ethical Issues in International Business

Table of Contents

1.0 Introduction

Domestic business is not the same with an international business. Thus, the ethics that governed domestic business are quite different from that of an international business. Ethical issues arise because of the differences in economic development, politics, legal systems and culture. The term ethics refers to accepted principles of right or wrong that governed the conduct of a person, the members of a profession, or the actions of an organization. Business ethics are the accepted principles of right or wrong governing the conduct of business people. This unit examines ethical issues as it affects international business.

2.0 Objectives

On successful completion of this unit, you should be able to:

a. State ethical issues in international business and
b. Explain ethical issues in international business

3.0 Main Text

3.1 Ethical issues in International Business

Most of the ethical issues in international businesses are rooted in the fact that political systems, laws, economic development and culture vary significantly from nation to nation. What is considered normal practice in one nation may be considered unethical in another. Because they work for an institution that transcends national borders and culture, managers, especially for international firms need to be particularly sensitive to these differences. Some of these ethical issues are thus briefly discussed below

i. Employment Practice

Working conditions vary from one nation to another, from one firm to another. This therefore raise some questions such as when work conditions in a host nation are clearly inferior to those in multinationals home nation, what standards should be applied? Those of the home nation or those of the host nation can they apply something in between? While some people may support that pay and work conditions should be the same across nation, how much divergence is acceptable? For example, Nigeria operates eight hours day work, while some nations such like Britain operates twelve hours day work. Also per day or hourly pay vary among nations of the world. For instance is considered as one of the least pay country. Hence, it is extremely difficult to suggest standards that should be applied. However, international business managers should endeavour to study employment practices as they applies to those host countries of their businesses.

ii. Human Rights

Questions of human rights can arise in international business. Some basic human rights are not respected in some nations, especially by the developing countries. For instance, rights that we take for granted in developing nations, such as freedom of association, freedom of speech, freedom of assembly, freedom of movement, freedom from political repression and so on, are by no means universally accepted. For example, during days of apartheid system in South-Africa, blacks were not permitted to participate in socio-economic activities which were dominated by the whites. But after the independence, this practice was abolished. In addition, during military regime in Nigeria, many citizens including journalists and human right activists were wrongfully detained. However, opposite exist nowadays in Nigeria.

The issue of foreign multinational firms doing business abroad violates human rights is critical in international business. For example, Nigeria is a country where serious questions have arisen over the extent to which foreign multinationals doing business in the country have contributed to human rights violation? For instance, the largest foreign oil producer in the country –Royal Dutch Shell has been criticized in Niger Delta over environmental pollution. Recently, Jonathan's administration ordered Shell Company should bear some environmental costs of their operations in Niger delta. Notwithstanding, as international business managers, issues of human rights should be critical studied and apply accordingly.

iii. Environmental Pollution

Ethical issues arise when environmental regulations in host nations are inferior to those in the home nation. For instance, many developed nations have substantial regulations governing the emission of pollutions, the dumping of toxic chemicals and so on. Some of these regulations are often lacking in developing nations, such like Nigeria. For example, according to a 1992 report prepared by environmental activists in Nigeria in Niger Delta region, it state that:

> Apart from air pollution from the oil industry's emissions
> flares day and night. Producing poisonous gases that are
> silently and systematically wiping out vulnerable air-
> borne biota and endangering the life of plants, game and
> man himself, we have widespread water pollution and
> soil/land pollution that results in the death of most
> aquatic eggs and Juvenile stages of the life of fin fish and
> shell fish on the other hand, whilst, on the other hand,
> agricultural land contaminated with oil spills, becomes
> dangers for farming, even when…

The implication in this description is that pollution controls applied by foreign companies in Nigeria were much laxer than those in developed nations, such like UK. Therefore, should a multinational feel free to pollute in a developing nation? Is there a danger that a moral management might move production to a developing nation because costly pollution controls are not required, and the company is therefore free to despoil the environment and perhaps endanger local people in its quest to lower production costs and gain a competitive advantage?

These questions take on added importance because some parts of the environment are a public good that no one owns but anyone can despoil. No one owns the atmosphere or the oceans, but polluting both, no matter where the pollution originates, harm all. The atmosphere and oceans can be viewed as a global commons from which everyone benefits but for which on one is specifically responsible. In such cases, a phenomenon known as the tragedy of the commons becomes applicable. The tragedy of the commons occurs when individuals overuse a resources held in common by all, but owned by no one, resulting in its degradation. The phenomenon was first named by Garrett Hardin when describing a particular problem in six-tenth century in England.

Self Assessment Exercise

Describe tragedy of the commons

iv. Corruption

Corruption has been a problem in almost every society in history and it continues to be one today. There always have been and always will be corrupt government officials. International businesses can and have gained economic advantages by making payments to these officials. For example, Carl Kotchian, the president of Lockheed, made a $12.5 million payment to Japanese agents and government officials to secure a large order for Lockheed's TriStar Jet from Nippon Air. When the payments were discovered, US officials charged Lockheed with falsification of its records and tax violations. Although such payments were supposed to be an accepted business practice in Japan, the recreations created a scandal there too. The government ministers in question were criminally charged, one committed suicide, the government fell in disgrace and the Japanese people were outraged. Apparently, such a payment was not an accepted way of doing business in Japan. The payment was officials, to secure a large order that might otherwise have gone to another manufacturer, such as 'Boeing'. This case took place in 1970s.

Recently, Senate Committee on Sale of Government Properties in Nigeria ordered Bureau for Public Properties (BPP) for public hearing over the sale of government properties during Obasanjo's administration. During the public hearing, the civil servants, and the communities where these properties were situated alleged that they were not carry along, and the money collected from such sales were not remitted to government accounts. It was revealed also during the public hearing that the foreigners who claimed to have bought these properties especially hotels, corporations, estates, etc, did not pay the actual money bided for these properties, and they have overused such properties without remittance to the government of Nigeria. The senate frown that this is an illegal act in Nigeria and thus the concerned victims are being prosecuted appropriately.

Research revealed that corruption reduces the returns on business investment and leads to low economic growth. In a country, where corruption is common, unproductive bureaucrats who demand side payments for granting the enterprise permission to operate may siphon off the profits fro a business activity. This reduces businesses incentives to invest and may retard a country's economic growth rate.

There are countless examples that could be sited, nevertheless, the message here that international investors should know each country business practice, especially where he/she wish to do business.

v. Moral Obligation

Multinationals has power to control their resources and to move production from country t country. Nevertheless, this power is constrained not only by laws and regulations, but also by the discipline of the market and the competitive process. Some moral philosophers argued that multinationals should give back something to the society where they derived profits. This is refers to social responsibility

The concept of social responsibility refers to the idea that business people should consider the social consequences of economic actions when making business decisions and that there should be a presumption in favour of decisions that have both good economic and social consequences. Advocates of this approach argued that business, particularly big successful businesses, such as Shell, Mobil, Total, etc need to recognizes their noblesse oblige and give something back to the societies that have mad their success possible.

On the contrary, there are examples of multinationals in Niger Delta of Nigeria, such Shell, Mobil, etc that have abused their power by neglecting social responsibilities. Most often, the areas of operations by these companies have been polluted. But, companies such as MTN, GLO, Airtel, etc in Nigeria have acknowledged a moral obligation to use their powers to enhance social welfare in the communities where do business, by building schools, building hospitals, offering scholarships, etc.

In conclusion, as international business managers, it is pertinent to critically study the ethics of the countries you wish to do business.

3.2 Theories of Business Ethics

This section examines some three theories of business.

1. Stakeholder Theory

The stakeholder theory of the firm is used as a basis to analyse those groups to whom the firm should be responsible. In this sense, the firm can be described as a series of connections of stakeholders that the managers of the firm attempt to manage. A stakeholder is any group or individual who can affect or is affected by the achievement of the organization’s objectives. Stakeholders are typically analyzed into primary and secondary stakeholders. Primary stakeholder group is one without whose continuing participation in the corporation will survived as going concern. A primary group includes investors, employees, customers and suppliers, together with the public. The secondary groups are defined as those who influence or affect the operations of the corporation but not engaged in any transaction with the corporation and thus not essential for its survival.

2. Social Contract Theory

The social contract theory has a long tradition in ethical and political theory. In general, this theory considers the society as a series of social contracts between members of society and society itself. The social contract theory in business ethics argues that corporate rights and responsibilities can be inferred from the terms and conditions of an imaginary contract between business and society

An integrated social contracts theory, as a way for managers to take decisions in an ethical context, has been developed. Here, distinction is made between macro social contracts and micro social contracts. Thus, a macro social contract in the context of communities, for example would be an expectation that business provides some support to its local community and the specific form of involvement would be the micro social contract. Hence companies who adopt a view of social contracts would describe their involvement as part of social expectation.

3. Legitimacy Theory

Legitimacy is defined as a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs and definitions. There are three types of organizational legitimacy: Pragmatic, Moral and Cognitive.

It should be pointed out that legitimacy management rests heavily on communication. Therefore, any attempt to involve legitimacy theory, there is a need to examine some forms of corporate communications.

Self Assessment Exercise

Briefly differentiate between primary and secondary stakeholders

4.0 Conclusion

There is no society that exists without some governing rules and regulations. Likewise business do not operates in isolation. Business do operates under certain prescribed laws, Acts, norms, culture, etc. This is refers as business ethics. Business ethics are the accepted principles of right or wrong governing the conduct of business people. Understanding of these ethical laws as they affects international business is inevitable in modern business.

5.0 Summary

In this unit, you learnt about business ethics, ethical issues in international business and theories of business ethics.

6.0 Tutor Marked Assognment

Explain legitimacy theory

Answer

Legitimacy theory is described as a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs and definitions. There are three types of organizational legitimacy: Pragmatic, Moral and Cognitive.

It should be pointed out that legitimacy management rests heavily on communication. Therefore, any attempt to involve legitimacy theory, there is a need to examine some forms of corporate communications.

7.0References/Further Readings

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New York, McGraw-Hill Companies

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Answers to Self Assessment Exercises

1. The tragedy of the commons describes when individuals overuse a resources held in common by all, but owned by no one, resulting in its degradation. The phenomenon was first named by Garrett Hardin when describing a particular problem in six-tenth century in England.

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2 Primary stakeholder group is one without whose continuing participation in the corporation will survived as going concern. A primary group includes investors, employees, customers and suppliers, together with the public. The secondary groups are defined as those who influence or affect the operations of the

corporation but not engaged in any transaction with the corporation and thus not essential for its survival.

UNIT 13: Financial Influence on International Business

Table o Contents

1.0 Introduction

Financial influence on an international business is an uncontrollable factor and they include foreign currency exchange Risks, National balance of payment, taxation, tariffs, national monetary and fiscal policies inflation and national business accounting rules. Though all these are controllable variables looking like disadvantages to a business concern, if well studied and apply accordingly they could turn out to be an advantage to a business concern. This unit examines financial influence on international business activities.

2.0 Objectives

After successful studying this unit, you should be able to:

a. Explain factors that affect international business finance.
b. Explain the implication of foreign currency on international business.

c. Explain balance of payment and
d. Explain tariff, taxation and Government regulatory policy on international business activities.

3.0 Main Text

3.1 Financial Forces

These are some financial factors that a business man who goes international struggles with in order to be successful in an international business. These factors are uncontrollable, because as a businessman you do not have control over them however; if you critically study them and take advantage of the opportunity being created by them, the sky may be your limit.

3.2 Fluctuating Currency Value

History has it that one of the major currencies Nigeria depends on in term of exchange is dollar. In early 90s and late 90, to be precise during Abacha's Regime, Nigeria Naira was about ₦70 to 75 per Dollar. But these days, that in 2011, Nigerian currency has been fluctuating between ₦160 and ₦ 180 per dollar.

The Essence of this account is to examine the effect of this on an international businessman who operates in Nigeria at this period. The cost of goods that are brought in from outside Nigeria will continue to rise and fall thereby affecting business activities either positively or negatively depending on situation at hand and the policies of the Government.

In situation, where the currency fluctuation is higher central bank intervenes in selling and buying the dollar. You must continue to look at exchange rate if you must go into an international business. With a press of button in your set you can get the currency value of naira against major currencies in the world. You must bear it in mind that the rates are not always stable

Self Assessment Exercise

List the values of dollars, pounds, and euro against Nigerian currency.

3.3 Foreign Exchange Quotations

Foreign Exchange Quotations- Is the price of one currency expressed in terms of another. Ball et al (2002), in the worlds currency exchange markets, the US dollar (US $) define it as the common unit being exchange for other currencies. Even if a holders of Japanese Yen (¥)wants British pounds (₣) the trade particularly if it involves a large amount, usually will be to buy US $s with the ¥ and then to buy pounds with the US $s**.**

3.4 Currency Exchange Controls

Ball et. al (2002) describes it as currency exchange control limit or prohibit the legal use of a currency in international transaction. Typically, the value of the currency is arbitrarily fixed at a rate higher than its value in the free market and it is decided that all purchase or sales of other currencies be made through a government agency, black markets inevitably springs up, but it is of little use to a finance manager who usually wants to avoid or break the laws of a country in which the company is operating. In addition, the black market is rarely able to accommodate transaction of the size involved in a multinational business.

In Nigeria the currency exchange was highly controlled with two different exchange rates- Inter banks rate and FEM rate. FEM rate determined at fortnightly auctions. Borrowing from abroad is subject to finance ministry approval. To incoming direct investment, approval is needed from finance ministry and ministry of internal affairs limits on foreign equity varies, 100% ownership is not allowed. Incoming Portfolio Market requires finance ministry approval. Remittance of dividends and profits, finance ministry approval is required. Delays are frequent, no ceilings is paid out of current-year after- tax profits. Remittance of interest and principal, finance ministry approval is required. Remittance of Royalties and fees, the finance ministry approval is required. Reparation of capital, finance ministry approval is required, followed by authorized foreign dealer approvals. Documentation for remittance is onerous and complex, transfer via authorize dealers only is allowed.

3.5 Balance of Payments

Balance of payments is described as a situation where countries export and import is equal. If the balance of payment is slipping into deficit, government is probably considering one or more market or non market measures to correct or suppress that deficit. This can be achieved through:

1. Currency devaluation
2. Restrictive monetary or fiscal policies
3. Currency or trade controls.

In terms of export, government will encourage export incentives, tax holidays, lower cost financing, or other advantages governments' give to international businesses to encourage them to export, buy goods and service. All these and affect an international business either positively or negatively.

Self Assessment Exercise

List two export incentives Nigeria has granted foreign investors.

3.6 Tariffs and Duties

The word Tariffs or Duties are used interchangeable, they are taxes usually imposed on imported goods. Tariffs and Duties are imposed on some goods for

i. Natural Defense
ii. Protect infant industry
iii. Protect Domestic jobs from cheap foreign labour
iv. Scientific Tariff or fair competition
v. Retaliation
vi. Other arguments in favour of tariffs and duties are:
   - Permit diversification of the domestic economy
   -improve of the balance of trade.

3.7 Taxation

Taxes are collected from corporations by government so as to provide social services to its citizen. So many people believe that customer pay taxes through high price of goods and the corporation transfers it to government. It means a company with lower taxes, charges its customers less for its product. This may sound truthful, but in practice is not the case in Nigeria.

International companies' pay more taxes because they operate in more countries; which entail a lot of documentation and paying necessary fees.

There are different taxes in different countries. If you study countries, you will discover that the income tax is the biggest revenue earner for governments especially in America. There are other taxes like value-added taxes, capital gain taxes, property taxes and social security.

3.8 Inflation

Increase in prices of goods and services over a period of time is known as inflation. History has it that inflation ended an economic boom in 1973 which was enjoyed immediately after World War II. Reasons for inflation may be because of

4. Rising demand
5. Increased money supplies

Inflation has a lot of effects on interest rates because companies borrow; the cost borrowing is dependent on the rate of inflation. Once inflation sets in, the borrower looses because the value of money is reduced and the person that borrows, gain, because the value of money has gone down.

Inflation equally has an effect on a country's monetary and fiscal policies. (Monetary policy is the amount of money in circulation, while fiscal policies are the collecting and spending of money by governments). Inflation has both positive and negative effect to a business especially the international business. To businessmen, High inflation encourages borrowing because on repayment it will be cheaper. High inflation rate bring about high interest rate and may discourage lending to businesses.

4.0 Conclusion

Financial influence on international business activities is considered critical for the success of international business. These include: Taxation, inflation, balance of payment, currency exchange control, tariffs and duties, foreign exchange and host of others. It could have both negative and positive effect on a business, depending on how a business man handles it.

5.0 Summary

In this unit you learnt about factors that affects international business finance, importance of foreign exchange currency on international business activities, such as Tariff, taxation and other government regulatory policies.

6.0 Tutor Marked Assignment

State two effect of inflation on business activities.

Answer

1. Inflation has a lot of effects on interest rates because companies borrow; the cost borrowing is dependent on the rate of inflation. Once inflation sets in, the borrower looses because the value of money is reduced and the person that borrows, gain, because the value of money has gone down.
2. Inflation equally has an effect on a country's monetary and fiscal policies. (Monetary policy is the amount of money in circulation, while fiscal policies are the collecting and spending of money by governments). Inflation has both positive and negative effect to a business especially the international business. To businessmen, High inflation encourages borrowing because on repayment it will be cheaper. High inflation rate bring about high interest rate and may discourage lending to businesses.

7.0 References/Further Reading

Ball A D, et al (2002) International Business- The Challenge of Global Competition, 8th Edition, Irwin ,McGrow-Hill

Answers to Self Assessment Exercises

1 The value of Dollar and Euros to Naira varied according to market demand in Nigeria

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2 Two export incentives given to exporters are: tax holidays and lower cost financing given to international businesses to encourage them to export, buy goods and services.

UNIT 14: International Monetary System

Table of content

1.0 Introduction

International monetary system is recognized as catalyst for the development of international trade and promotion of currency movements across national frontiers. This unit provide a comprehensive analysis of the various monetary systems that are available in ensuring and facilitating international business across the globe. The systems discussed in this unit include; Bretton Woods system and European monetary systems.

2.0 Objectives

At the end of this unit, you should be able to:

- Trace the origin of international monetary systems
- Discuss the Bretton wood and European monetary systems and
- Identify the features of European monetary system

3.0 Main Text

3.1 International Monetary System Defined

International monetary system refers to the system prevailing in world foreign exchange markets through which international trade and capital movements are financed and exchange rates are determined.

3.2 Bretton Woods System

During the period preceding World War I almost all the major national currencies were on a system of fixed exchange rates under the international gold standard. This system had to be abandoned during World War I. There were fluctuating exchange rates from the end of the War to 1925. Efforts were made to return to the gold standard from 1925. But it collapsed with the coming of the Great Depression. Many countries resorted to protectionism and competitive devaluations-with the result that world trade was reduced to almost half. But depression completely disappeared during World War II.

In July 1944, the allied countries met at Bretton Woods in the USA to avoid the rigidity of the gold standard and the chaos of the 1930s in international trade and finance and to encourage free trade. The new system was the present International Monetary Fund (IMF) which worked out an adjustable peg system.

Under the Breton Woods system exchange rates between countries were set or pegged in terms of gold or the US dollar at $35 per puce of gold. This related to a fixed exchange rate regime with changes in the exchange within a band or rage from 1 per cent above to 1 per cent below the par value. But these adjustments were not available to US which has to maintain the gold value of dollar. If the exchange rate hit either of the bands, the monetary authorities were obliged to buy or sell dollars against their currencies. Large adjustments could be made where there were "fundamental disequilibrium" (i.e. persistent and large deficits or surpluses) in BOP with the approval of the IMF and other countries. Member countries were forbidden to impose restrictions on payments and trade, except for a transitional period. They were allowed to hold foreign reserves partly in gold and partly in dollars. These reserves were meant to incur temporary deficits or surpluses by member countries, while keeping their exchange rates stable. In case of a BOP deficit, there was a reserve outflow by selling dollar and reserve inflow in case of a BOP surplus.

Reserve outflows were a matter of concern under the Bretton Woods system. So the IMF insisted on expenditure reducing policies and evaluation to correct BOP deficit. Temporary BOP deficits were also met by borrowing from the Fund for a period of 3 to 5 years. A country could borrow from the Fund on the basis of the size of its quota with it. The loans by the IMF were in convertible currencies.

The first 25 per cent of its quota was in gold tranche which was automatic and the remaining under the credit tranches which carried high interest rates. To provide a long-term loan the World Bank (or IBRD) was set up in 1946 and subsequently it two affiliates, the International Finance Corporation (IFC) in 1956 and International Development Association (IDA), in 1960, for the removal of trade restrictions, the General Agreement on Tariffs and Trades (GATT) came into force from January 1948. To supplement its resources, the Fund started borrowing from the ten industrialised countries in order to meet the requirements of the international monetary system under General Agreement to Borrow (GAB) from October 1962. Further, it created special Drawing Rights (SDRs) is January 1970 to supplement international reserves to meet the liquidity requirement of its members. The Bretton Woods system worked smoothly from 1950s to mid 1960s. During this period world output increase and with the reduction of tariffs under the GAFT, world trade also rose.

Self Assessment Exercise

Define International monetary system

3.3 Collapse of Bretton Woods System

The following are the principal causes sequences of the breakdown of the Bretton Woods system:

1. Built-in Instability

The Bretton Woods System had a built-in instability that ultimately led to its breakdown. It was an adjustable peg system within plus or minus 1 per cent of the par value of $ 35. In case of fundamental disequilibrium, a country could devalue its currency with the approval of the IMF. But countries were reluctant to devalue their currencies because they had to export more goods in order to pay for their imports from other countries. This led countries to rely on deflation in order to cure BOP deficits through expenditure-reducing monetary fiscal policies.

2. The Tariff in Dilemma

Since the dollar acted as a medium of exchange, a unit of account and a store of value of the IMF system, every country wanted to increase its reserves of dollar which led to dollar holdings to a greater extent than needed. Consequently, the US gold stock continued to decline and the US balance of payment continued to deteriorate. This is the Tariff in Dilemma which actually led to the collapse of the Bretton Woods System in 1971.

3. Lack of International Liquidity

There was a growing lack of international liquidity due to increasing demand for the dollar in world monetary markets. With the expansion of world trade, BOP deficits (and surpluses) of countries increased. This necessitated the supply of gold and of the dollar. But the production of gold in African was increasing every little. This led to larger demand and holdings of the dollar. Countries also wanted to have more dollar holdings because they earned interest. As the supply of dollars was inadequate in relation to the liquidity needs of countries, the US printed more dollars to pay for its deficits which other countries accepted as reserves.

4. Mistakes in US Policies

The BOP deficits of the US became steadily worse in the 1960s. To overcome them, the policies adopted by the US government ultimately led to the world crises. Rising US government expenditure in the Vietnam War, the financing of US space programme and the establishment of the "Great Society" (social welfare) programme in the 1960s led to large outflow of dollar from the US. But the US monetary authority did not devalue the dollar. Rather, it adopted monetary and fiscal measures to cut its BOP deficit.

5. De-stabilising Speculation

Since countries with "fundamental disequilibrium" in BOP were reluctant to devalue their currencies and also took time to get the approval of the IMF, it provided speculators an opportunity to resort to speculation in dollars. When devaluations were actually made, there were large doses of devaluation than originally anticipated. This was due to de-stabilising speculation which made controls over capital flows even through monetary-fiscal measures ineffective.

6. Crisis of Confidence and Collapse

The immediate cause of the collapse of the Bretton Woods System was the eruption of a crisis of confidence in the US dollar. The pound had been devalued in 1967. There was no control over the world gold market with the appearance of a separate price in the open market. The immediate cause for the collapse of the Bretton Woods System was the rumour in 1971 that the US would devalue the dollar. This led to a huge outflow of capital from the US. The US in the order hand, suspended the conversion of dollars into gold when some small European central banks wanted to convert their dollar reserves into gold at the US. It refused to intervene in the foreign exchange markets to maintain exchange rate stability and imposed a 10% import surcharge.

3.4 European Monetary System

The European Monetary System (EMS) was officially launched in 1979 under the sponsorship of German Chancellor Helmut Schmidt and French President Valery Giscard d'Estaing. The nine European Community members who fully participate in the EMS include: Britain, Belgium, Denmark, France, West Germany, Ireland, Luxembourg, Netherlands and of course Italy also later agrees to participate in the system under modified conditions due to difficulties it experienced with its currency. The European Monetary System, commonly referred to as the EMS, is an arrangement among the member nations to limited fluctuations in their currencies and achieves monetary stability. It was taught that international trade between the participating nations would be improved if exchange rates were stable and predictable.

3.5 Features of European Monetary System

The European Monetary System (EMS) consists of a number of special features, such as a common currency unit, detailed regulation of permissible currency fluctuations among member nations, mutual credit facilities for participating countries, and the creation of a central reserve fund consisting of Gold, Dollars, and the currencies of the participating countries.

3.6 Suggestions for Monetary System Reform

Economists have suggested a number of measures in order to avoid the excessive fluctuations and large disequilibria in exchange rates for reforming the present world monetary system.

1. Coordination and Cooperation of Policies

Experts suggested that there should be international co-operation and co-ordination of policies among the leading developed countries for exchange rate stability. The most industrialized countries of the world such as the US, Germany and Japan should have the optimal degree of exchange rate stability by fixing the exchange rates among their currencies at the equilibrium level based on the purchasing power parity.

2. Establishing Target Zones

A call had also been made for the establishment of target zones within which fluctuations in exchange rates of major currencies may be permitted. According to experts, the forces of demand and supply should determine the equilibrium exchange rate. There should be an upper target zone of 10% above the equilibrium rate and a lower target zone of 10% below the equilibrium exchange rate. The exchange rate should not be allowed to move outside the two target zones by official intervention.

3. Improving Global Liquidity

The reform package of the present world monetary system should improve global liquidity. As a first step, both BOP deficit and surplus countries should take step to reduce a persistent imbalance through exchange rate changes via internal policy measures.

Second, they should also cooperate in curbing large flows of “hot money” that de-stabilise their currencies. Third, they should be willing to settle their BOP imbalances through SDRs rather than through gold or dollar as reserve assets. Fourth, there should be increasing flow of resources to the developing countries.

4. Leaning against the Wind

To reduce the fluctuations in exchange rates, the IMF Guidelines for the Management of Floating Exchange Rate, 1974 suggested the idea of leaning against the wind. It means that the central banks should intervene to reduce short-term fluctuations in exchange rates but leave the long-term fluctuations to be adjusted by the market forces.

5. Establishment of Global Central Bank

There should be a global central bank with a global currency which should be a global lender of last resort.

6. Creation of International Bankruptcy Court

It was also proposed by experts that International Bankruptcy Court should be created which should deal with countries.

7. Objective Indicators

To iron out exchange rate fluctuations, the IMF Interim Committee suggested the adoption of such objective indicators as inflation unemployment, growth of money supply, growth of GNP, fiscal balance, balance of trade and international reserves. The variations in these indicators require the adoption of restrictive monetary-fiscal measures to bring stability in exchange rates.

Self Assessment Exercise

Identify the factors responsible for the collapse of Bretton Woods System.

4.0 Conclusion

In this unit you learned about the development of Bretton Woods and European Monetary systems. The reasons for the spectacular collapse of

Bretton Woods's monetary system were also expatiated as well as the common features of European Monetary System.

5.0 Summary

International monetary system is a system prevailing in foreign exchange market through which international trade and capital movements, in particular international business are financed
Bretton Woods system exchange rates between countries were pegged in terms of gold or the Unites States dollar. However, the system collapse for lack of international liquidity and the fact that the overall system was built on instability.

6.0 Tutor Marked Assignment

Enumerate the features of European Monetary System.

7.0 References/Further Readings

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Answers to Self Assessment Exercises

1 International monetary system refers to the system prevailing in world foreign exchange markets through which international trade and capital movements are financed and exchange rates are determined.

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2 Some of the arguments advanced for the spectacular collapsed of Bretton Woods Monetary System include; Built-in Instability, Tariffin Dilemma, Lack of International Liquidity, Mistakes in US Policies, Destabilizing Speculation, Crisis of Confidence and Collapse.

UNIT 15: International Liquidity

Table of Contents

1.0 Introduction

International liquidity is crucial to the development of country’s economy as it is a yard-stick for participating in the world monetary system. This unit provides detailed analysis of the importance of International liquidity as it affects international business activities.

2.0 Objectives

On successful completion of this unit, you should be able to:

- Define the meaning of international liquidity
- Identify the problems associated with international liquidity and
- Discuss the concept of Special Drawing Rights

3.0 Main Text

3.1 International Liquidity Defined

International liquidity refers to the availability of internationally acceptable means of payment. It comprises all types of generally acceptable assets available to the countries for financing the deficits in their international balance of payments. In common language, international liquidity means international reserves. International reserves have been defined to include official holdings of gold, foreign exchange, special drawing rights (SDRs), reserve position in the IMF. Private holdings of foreign assets are not included in international liquidity.

Therefore, international liquidity is the sum total of the international reserves of all nations participating in the world monetary system. The world's need for international liquidity depends upon; the volume of international business transactions, and the imbalances that characterize these transactions. Given the volume of world trade and payments, the greater the collective payments imbalances of the participating countries, the more pronounced will be the overall need for international liquidity.

3.2 Problems of International Liquidity

The problem of international liquidity is concerned with the imbalances in the demand for and supply of international liquidity. International liquidity shortage (i.e., the demand exceeding the supply) leads to recession in the world economy. On the contrary, international liquidity surplus (i.e., supply exceeding demand) tends to have inflationary impact on the international business activities. Answer to the problem of international liquidity relates to the attempt to ensure that there exists neither a liquidity shortage nor a liquidity surplus. The supply of and demand for international liquidity must be balanced so that the contraction or expansionary pressures do not disturb the world trade. The international liquidity should play a neutral role of lubricating international business and the mechanism without generating destructive forces of its own.

3.3 International Liquidity Problem in Developing Countries

The liquidity problem is all the more serious and is of different nature in the developing and less developed countries. These countries experience chronic deficiency of capital and technology and have to depend largely on the developed countries for their scarce resources. They required resources for; covering their short-term balance of payments resources, and for meeting long-term capital requirement of economic growth. The liquidity problem of the developing countries has the following features which are quite different from those of the developed countries.

1. Undeveloped Financial Markets

Domestic financial markets in the developing countries are undeveloped and are subject to heavy government control. These characteristics have the following effects:

- Lending often takes place at artificially low interest rates fixed by the government to favour certain industries or sectors of the economy.

This means an implicit subsidy to the recipients of the loans and an implicit tax on the banking system,

- Few and not very attractive assets are available to the savers.
- Government controls prevent domestic savers from holding foreign assets all these effects indicate discouragement to domestic saving which is already at the low level because of low income levels.

2. Heavy Government Expenditures

Government spending in the developing countries forms a very high percentage of national income. In order to finance its budget deficits, the government resorts to the printing of new money (i.e. deficit financing) which usually result in high rates of inflation.

3. Exchange Control

In the developing countries, exchange rates are set by the central bank rather than determined in the foreign exchange market. Private international borrowing and lending are strictly restricted. The residents are allowed to purchase foreign exchange only for certain selected purposes.

4. Primary Exports

Most of the developing countries mostly rely for their export earnings on a small number of natural resources or agricultural products. Dependence on such primary products makes these countries vulnerable to shocks in the international markets because the prices of these goods are highly variable relative to those of manufactured goods.

5. Dependence of Foreign Borrowing

Since most of the developing countries have low saving rates and very high investment opportunities, they largely rely on capital inflow from abroad to finance their domestic investment. Recently, these countries have borrowed on a large scale from rich countries and have built up a large debt to the rest of the world.

Self Assessment Exercise

State factors responsible for liquidity problems in developing nations.

3.4 IMF and International Liquidity

The International Monetary Fund (IMF) has been established with an objective of extending short-term financial assistance to its members to overcome the balance of payments difficulties as well as emergency situations. It contributes to the international liquidity in two ways: by providing conditional liquidity; and by providing unconditional liquidity.

1. Conditional Liquidity

The IMF provides conditional liquidity under its various lending schemes. The credit provide to the members is generally subject to certain conditions. Most of the IMF loans require an adjustment programme to be undertaken by the member country for improving its balance of payments position. Moreover, obtaining funds from the IMF under agreed conditions increases the member's access to international capital market.

Important credit facilities provided by the IMF are: basic credit facility, extended fund facility, compensatory financing facility, buffer stock facility, supplementary financing facility, trust fund, and structural adjustment facility amongst others. In order to make the resources easily and more adequately available, the IMF has been introducing various procedure changes from time to time.

2. Unconditional Liquidity

The supply of unconditional liquidity takes the form of reserve assets that can be used for balance of payments financing. The IMF provides unconditional liquidity through the allocation of Special Drawing Right (SDRs), and also in the form of reserve positions in the Fund to member countries without having to enter into policy commitments with the fund.

3.5 Concept of Special Drawing Righ**ts**

The establishment of the scheme of Special Drawing Right (SDRs) is a significant attempt of the International Monetary Fund (IMF) to reform the international monetary system and to solve the problem of intentional liquidity. After the World War II, the gold standard was replaced by the currency standard. But the continued use of the pound sterling and the U.S. dollar as the key reserve currencies proved unsatisfactory because of the deficits in the balances of payments of the U.S. and the U.K. There was a serious problem of the international liquidity, i.e. the inadequate growth of monetary reserves. In such conditions, the need arose for a new reserve asset thus leading to the introduction of SDR as a new international reserve asset by the IMF. The scheme for creating Special drawing Rights (SDRs) was outlined at Annual Meeting of the IMF in October 1967 at Rio de Janeiro (Brazil). The detailed proposals of the scheme were approved by the Board of

Governors in April 1968 and the Special Drawing Account came into being on August 6, 1969. The basic idea behind the SDR scheme was to establish a new reserve asset whose quantity could be consciously adjusted in response to the world's need for international reserves. The objective of creation of the SDR was to assure an adequate, but not excessive, growth of monetary reserves.

Under this scheme, the IMF has the power to grant SDRs to member nations on a specified basis. Allocation of SDRs is made annually by the collective decision of the participating countries on the basis of their quotas. Possession of SDRs entitles a country to obtain a defined equivalent of currency from other participating countries. The IMF can create new SDRs from time to time in response to the need for additional international reserves. The newly created SDRs are allocated among member nations in proportion to their IMF quotas. When a member's SDR balance falls below its total allocation, it must pay interest to the IMF on the difference. Similarly, the members are paid interest by the IMF on SDR holdings in excess of allocations. Thus, by creating SDRs, the IMF aims at increasing the availability of resources to the member countries without putting additional train on its own resources.

3.6 Features of SDRs

The following are the salient features of SDR s:

1. Additional Reserve Asset

The SDRs scheme provides a new international asset, in addition to the traditional assets, i.e., gold, key currencies. Now, the member countries of the IMF can hold and use SDRs along with gold and key currencies as international reserves.

2. Cheque Book Currency

In the physical sense, SDRs are a cheaque-book currency and are created with the strokes of pen. They are simply book keeping entries at the IMF in accounts for the member countries and the Fund itself. They are just like coupons which can be exchanged for currencies needed by the holder of SDRs for making international payments.

3. Transferable Assets

SDRs are transferable assets. The member countries are required to provide their currencies in exchange for SDRs. A country can acquire convertible currency in exchange for SDRs. A country can acquire convertible currency from the designated country in exchange for SDRs. Designated country is that which has strong balance of payments or large reserves.

4. Backing of SDRs

SDRs are a liability of the IMF and asset of the holders. There is no backing for SDRs in the form of an asset like key currency. The real backing is the undertaking given by the member countries to abide by the SDR regulations. The country which agrees to the creation of SDRs is obliged to permit drawal and other countries are obliged to accept them as unit of adjustment.

5. Basis of SDRS

The creation of SDRs is based on the fundamental principle of credit creation in the banking system. The SDR scheme is an extension of this principle to the international level. The IMF can create new SDRs without any increase in deposits of gold or currency by the participating countries. Thus, issue of SDRs means an increase in world's monetary reserves.

6. Allocation of SDRs

The SDRs are allocated to the member countries in proportion to their quotas in the IMF. The lion's share goes to the developed countries and the developing countries get only about a quarter.

7. Special Drawing Account

Under the changed rules, the IMF maintains two separate accounts: General Account which deals with the general transactions of the IMF relating to quotas, subscriptions, ordinary drawings, etc. and Special Drawing Account which deals with SDRs are created as a percentage of existing resources (quotas).

8. Paper Gold

Initially the scheme envisaged that the SDRs would be a sort of paper gold. Their value was fixed in terms of gold. But, since 1974, the SDR has been valued on the basis of a currency basket.

9. Fiduciary Reserve System

The SDR scheme proposes a purely fiduciary reserve system. SDRs are regularly created by the IMF, accepted by the number countries as paper gold reserves and used for the settlement of international payments.

10. Interest-Bearing Asset

SDRs are interest-bearing assets. The IMF pays interest to the countries holding SDRs and charge interest from the countries using SDRs.

It should however be noted that there are features of SDR

Self Assessment Exercise

What are the reasons for inadequacy in International reserves?

4.0 Conclusion

In this unit you have learned about international liquidity and it basic compositions as well as the feature associated with the liquidity problem in developing countries like Nigeria. Special Drawing Rights (SDR) and its features were also discussed

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5.0 Summary

International liquidity consists of all total reserves of all nations participating in the world monetary system. The inadequacy of international liquidity is caused by inadequate growth of reserves, uneven expansion of reserves, slow growth of gold, and the lack of solution by rising IMF Quota. However, the problem of liquidity in developing countries is caused by factors such as undeveloped financial markets, heavy government expenditures, exchange control, primary exports, dependency of foreign borrowing, forms of foreign borrowing and corruption

6.0 Tutor Marked Assignment

Identify the features of liquidity problems in Nigeria as a developing country.

7.0 References/Further Readings

Bello, L (2008) International Banking, *Lagos, National Open University of* Nigeria

Jhingan, M.L. (1998); Principles of Economics, New Delhi: Vrinda Publications Ltd.

Paul, R.R. (1996); Money, Banking and International Trade, New Delhi: Kalyani Publishers.

Answers to Self Assessment Exercises

1 Factors responsible for liquidity problems in developing nations are:

a. Undeveloped Financial Markets

b. Heavy Government Expenditures

c. Exchange Control

d. Primary Exports and

e. Dependence of Foreign Borrowing

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2 Some of the reasons advanced for inadequacy of international reserves includes: inadequate growth of reserves, uneven expansion of reserves, slow growth of gold, and the lack of solution by rising IMF Quotas.

UNIT1 6: International Finance and Lending Institutions

Table of Content

1.0 Introduction

The need for financial assistance for developing nations is great and generates a higher degree of risk than normally encountered in traditional commercial lending situations. International Lending agencies have been established to fill the needs of developing and other countries. Although these agencies are numerous, this unit traces the origin, objectives as well as the working structure of major ones among them.

2.0 Objectives

On successful study of this unit, you should be able to:

- Identify the various International Financing and Lending agencies.
- Explain the working organization or structures of these agencies and
- State the objectives behind each of agencies

3.0 Main Text

3.1 International Monetary Fund

International Monetary Fund (IMF) is an international monetary institution established by different countries after the World War II with an objective of providing exchange stability throughout the world and increasing liquidity so that balanced multilateral trade is promoted through the cooperation of the member nations. Various historical conditions and events that led to the establishment of IMF are summarized below:

(i) Gold standard functioned with reasonable success and provided a medium of international payments before World War I.

(ii) The onset of World War I forced most of the countries to abandon gold standard and put restrictions on the movement of gold as well as goods.

(iii) After the World War I, some countries came back on the gold standard but the gold standard could not work well between the periods 1919 –1931.

(iv) The world faced the Great Depression of the thirties between 1929 and 1936. Prices, profits, share prices, production, employment and income of the leading countries fell very low. Competitive devaluation, tariffs and exchange controls were adopted by the nations.

(v) World War II (1939-45) further disrupted the pattern of international trade and dislocated the economies of the world.

After the world-wide depression and the World War II, it was recognised that; the gold standard could not be restored in future; and lack of any mechanism like the gold standard would generate instability of exchange rates and discourage international trade and investment. Therefore, the monetary authorities of the world felt the need for international cooperation to establish a stable international monetary order. With this objective, a conference of 44 major countries was held at Bretton Woods, New Hampshire, in 1944. The result of this conference was the establishment of the International Monetary Fund

(IMF) and the International Bank for reconstruction and Development (IBRD). These two institutions are known as Bretton Woods's twins.

Objectives of IMF

Basically, the purpose of the IMF was to; achieve the international advantages of the gold standard without subjecting nations to its internal disadvantages; and achieve internal advantages of paper standard while avoiding its international disadvantages. The main objectives of the Fund, as summarised in the Article of Agreement, are as follows:

(i) To promote international monetary cooperation through a permanent institution that provides the machinery for consultation and collaboration on international monetary problems.

(ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economy policy.

(iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciations.

(iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

(v) To give confidence to members by the Fund's resources available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

(vi) In according with the above, to shorten the duration and lesson the degree of disequilibria in the international balance of payments of members.

Organization of IMF

The IMF came into existence in December 1945 and started functioning in March 1947. It is an autonomous organization and is affiliated to the U.N.O. It has its main office in Washington. Initially, the IMF had 30 countries as its members. Nowadays, the members is increasing as more prospective members are desiring to be part of the organization

The management of the Fund is under the control of two bodies: Board of Governors and Board of Executive Directors. The Board of Governors is the general body of management consisting of one Governor and an Alternate Governor for each member country. The Board of Governors has the responsibility of formulating the general policies of the Fund. The Board of Executive Directors controls the day to-day activities of the Fund. Currently, it consists of 22 directors; six of these directors are appointed by the members having the largest quotas, namely, the United States, the United Kingdom, West Germany, France, Japan and Saudi Arabia, and the remaining sixteen directors are elected by other nations. The Managing Directors is the chairman of the Board of Executive Directors as well as the head of the staff of the Fund.

Resources of IMF

The resources of the IMF are subscribed by the members. The subscription quota of each member is based on its national income and its position in the international trade/business. Every member nation must contribute 25% of its quota in international reserve assets and the remaining 75% in its own currency. The payment of 25% part of the quota was originally in gold, but now it is in Special Drawing Rights (SDRs). SDRs are an international reserve asset created by the IMF in 1969. The Fund may also enlarge its resources by borrowing, by selling gold to the public and by receiving fee from the borrowing members.

3.2 International Development Association

The International Development Association (IDA) was established in 1960 as an affiliate to the World Bank. As matter of policy, the World Bank's finance is conditional and inadequately meets the credit requirements of the underdeveloped countries. Its loans are for specific development purposes; bear relatively high rate of interest and are for relatively short period. There are many projects (such as irrigation, railway construction, education, public health, housing etc.) in the underdeveloped countries which are vital to general economic development, which have longer gestation period and which do not yield sufficient returns to meet the amortisation charges. As per rules of the World Bank, loan cannot be given for such general development projects. The IDA was started to supplement the World Bank's development assistance and to make available loans to the developing countries on softer terms and for longer periods. The main objectives of the IDA are as follows:

(i) To provide development finance to the less developed countries on easy and flexible terms.

(ii) To promote economic development, increase productivity, and thus, raise the standard of living in the less developed countries.

(iii) To supplement the objectives and activities of the World Bank.

Organizational Structure of IDA

The membership of the IDA is open to all the members of the World Bank. The members of the IDA are divided into two parts. Part 1 countries are developed countries which are required to pay their subscription in gold or freely convertible currencies. Part II countries are less developed countries which are required to pay on 10% of their subscription in gold or freely convertible currencies and the remaining

90% is payable in their domestic currencies. Nigeria falls in Part II. Legally and financially, IDA is a distinct entity from the World Bank, but is administratively managed by the same staff.

Financing Policy of IDA

The IDA loans are different from the conventional loans, the following are the distinctive features of the financing policy of the IDA:

(i) The IDA grants loans for protects whether they are directly productive or not.

(ii) The IDA loans are interest free; only a nominal annual rate of 3.4% on the amounts withdrawn and outstanding is charged to meet the administrative expenses.

(iii) The IDA loans are for long periods, i.e., for 50 years.

(iv) There is a 10 years of grace and no amount is repayable during this period of grace. After this only 1% of the principal is to be repaid annually for 10 years and 3% annually for the remaining 30 years.

(v) IDA loans are generally repayable in foreign exchange.

(vi) IDA loans are granted to the government of the country concerned.

3.3 International Financial Corporation

International finance Corporation (IFC) was established in July 1956 as an affiliate of the World Bank to provide finance to the private sector. The World Bank grants loans to the governments of the member countries or provides loan capital to the private enterprises out of the guarantee of the member governments. Moreover the World Bank does not provide risk capital. The IFC was established with the specific purpose of providing risk capital to the private enterprises in the less developed countries without government guarantee.

IFC Organization Structure

Though the IFC is affiliated to the World Bank, but it is a separate legal entity with separate fund and functions. The membership of the Corporation is open only to the members of the World Bank. The organization of the Corporation is the same as that of the World Bank. The Board of Governors and the Executive Directors of the World Bank also function as the Board of Governors and the Executive Directors of the IFC. The Corporation started with the initial authorised capital of $100 million which has been increased from time to time. The subscription quota of each member is proportionate to its share of subscription to the capital of the World Bank.

IFC Investment Policy

The following are the main features of the investment policy of the IFC:

(i) The IFC considers only those enterprises which are predominantly industrial and contribute to economic development of the country.

(ii) The project to be financed by the IFC must be in the private sector and must be productive in nature

(iii) Before making any investment, the Corporation satisfies itself that the enterprise has experienced and competent management.

(iv) The IFC's loan will not be more than half of the capital needed for an enterprise.

(v) The minimum investment to be made by the IFC to a single enterprise is fixed at $ 100,000: no upper limit is fixed.

(vi) The rate of interest for the IFC loan is determined by mutual negotiation, depending upon the degree of risk involved and other terms of investment.

(vii) The IFC's loans are disbursed in lump-sum or in instalments and are repayable in a period of 5 to 15 years.

3.4 African Development Bank

The African Development was formed under the auspices of the Economic Commission for Africa. Although the agreement establishing the bank was signed in Khartoum, Sudan on 4th August, 1963 and came into force about a year later, the actual operation commenced only in July, 1966. Its head office is located at Abidjan, Cote D'Ivoire.

Functions

The bank's main functions as set forth in the statute establishing it are:

- To use the resources at its disposal for financing of investment projects relating to the economic and social development of its members.
- To undertake and participate in the selection, study and preparation of projects enterprises and activities contributing to such development
- To mobilize both within Africa and outside Africa, resources for the financing of such investment programmes.
- To promote investment in Africa of public and private capital in projects or programmes
- To provide such technical assistance as may be needed in Africa for the study, preparation, financing and execution of development projects or programmes and
- To undertake such other activities and provide such other activities as may advance its purpose

Sources of Finances: More specifically, the bank's ordinary capital resources come from the following sources:

- Subscribed capital by members
- Fund raised through borrowing by the bank
- Fund received in repayment of past loans
- Income derived from the bank's loans and guarantees
- Any other funds received that do not constitute special sources

Self Assessment Exercise

State functions of African Development Bank

Organizational Structure of ADB

The consist of a Board of Governors , Board of Directors, a President, at least one Vice-President and other officers and staff. All powers of the bank are vested in the board of governors appointed by each member of the bank who exercises the voting power to which that member state is entitled. Each governor is entitled to a five year term, but can be reappointed for another term.

Self Assessment Exercise

State the various Source of finance of African Development Bank.

4.0 Conclusion

The students have learned in this unit various International financing agencies and their respective functions. We have also identified the various objectives the agencies are established to achieve. One of such objectives includes the provision of access for investment capital needed for infrastructure development in the member countries.

5.0 Summary

In this unit we have discuss and provides comprehensive explanation of the various International Financing agencies such as the International Monetary Fund (IMF), International Finance Corporation (IFC), International Development Association (IDA), and the African Development Bank (ADB). This analysis includes the objective, working structure as well as the sources of funding available.

6.0 Tutor Marked Assignment

State main functions of African Development Bank

7.0 References/Further Readings

Bello, L(2008): International Banking, Lagos, National Open University of Nigeria

Luckett, D.G. (1980); Money and Banking, New York: McGraw-Hill.

Paul, R.R. (1996); Money, Banking and International Trade, New Delhi: Kalyani Publishers.

Answers to Self Assessment Exercise

The bank's main functions ADB are:

1. To use the resources at its disposal for financing of investment projects relating to the economic and social development of its members.
2. To undertake and participate in the selection, study and preparation of projects enterprises and activities contributing to such development
3. To mobilize both within Africa and outside Africa, resources for the financing of such investment programmes.
4. To promote investment in Africa of public and private capital in projects or programmes
5. To provide such technical assistance as may be needed in Africa for the study, preparation, financing and execution of development projects or programmes and
6. To undertake such other activities and provide such other activities as may advance its purpose

The African development Bank (ADB), source it finances from; subscribed capital by members, Fund raised through borrowing by the bank, Fund received in repayment of past loans, Income derived from the bank’s loans and guarantees, and Any other funds received that do not constitute special sources